Publications

23

CA1
EA
-T66

TRADE POLICY

Research 2001



Canada

Digitized by the Internet Archive
in 2022 with funding from
University of Toronto

https://archive.org/details/31761115532269

TRADE POLICY
Research 2001



Printed in Canada

© Minister of Public Works and Government Services
Canada 2001
ISBN 0-662-29794-6
Catalogue number: E2-211/2000E

(Publié également en français)

Table of Contents

Foreword i

Part I: Reflections on Trade Policy Post-Seattle

1. Trade and Coherence: A Roundtable Discussion 1
Dan Ciuriak (rapporteur), Department of Foreign Affairs and International Trade

2. What It Will Take to Get Developing Countries into a New Round of Multilateral Trade Negotiations 18
Jagdish Baghwati, Columbia University

3. Trade and Coherence: Where the Major Gains Lie . . 26
Gary Hufbauer, Institute for International Economics

Part II: The "Trade and..." Agenda

4. Trade Liberalization: The Broader Context 32
Robert T. Stranks, Department of Foreign Affairs and International Trade

5. Addressing Trade-Related Development Needs: Options for the Donor Community 52
Kerry David Max, Canadian International Development Agency

6. Trade Liberalization: Culture, Identity and Social Cohesion 71
Bruce Jamieson, Department of Canadian Heritage

7. International Trade, Health Systems and Services: A Health Policy Perspective 135
Jake Vellinga, Health Canada

7. Trade and Environment: Post-Seattle Looking Forward 186
Robert T. Stranks, Environment Canada

9. Trade, Employment and Wages: A Review of the Literature 205
Philippe Massé, Human Resources Development Canada

Part III: Implications for Trade Policy

10. The Case for a New Round: Has It Been Made? . . . 226
Dan Ciuriak, Department of Foreign Affairs and International Trade

10. The "Trade and" Agenda: Are We at a Crossroads? 249
Dan Ciuriak, Department of Foreign Affairs and International Trade

12. Trade and Civil Society: Toward Greater Transparency in the Policy Process 295
John M. Curtis, Department of Foreign Affairs and International Trade

Foreword

This volume brings together the results of research and analysis conducted by the World Trade Issues Working Group from late 1999 through 2000, under the overall aegis of the Global Challenges and Opportunities Network (GCON). GCON had been launched as part of a larger policy research initiative (PRI) to advance the general objective of enhancing policy research capacity within the Government of Canada. Given the pervasive impact on national policies of globalization and trade liberalization, a key area for research centred on issues raised by Canada's participation in the global trading system.

As it happened, the timing of this initiative was fortuitous: the failure to launch a new round of multilateral trade negotiations at the World Trade Organization (WTO) Ministerial meeting in Seattle in December 1999 laid bare a number of fault lines and raised a spate of issues concerning the future direction of global trade policy. The World Trade Issues Working Group tackled these issues through a series of seminars with invited trade policy experts and research papers. The results have deepened understanding of the issues within the government; it is hoped through this compilation to make this work more widely available.

The papers compiled in this volume are very much in the spirit that the PRI envisaged when it launched the GCON working group process. The papers were for the most part written in the personal capacity of staff members from a wide range of participating departments; and they resulted in horizontal, cross-cutting analysis of challenging policy issues confronting the Government of Canada as a whole, while at the same time helping to rebuild the research capacity of the various participating departments. The interdepartmental collaboration created a new network of researchers, helping to break down the "stovepipe" approaches that are widely recognized as inadequate in addressing the complex interdisciplinary issues now facing public governance.

Particular credit for stimulating and leading this effort is due to the Chair of the World Trade Issues Working Group, John Curtis, Senior Advisor and Co-ordinator, Trade and Economic Policy, at the Department of Foreign Affairs and International Trade (DFAIT). John leveraged this output through a shoestring base budget, augmented by contributions elicited through a tireless "rainmaking" campaign within and outside DFAIT, and ensured that the work received prominent attention both at a featured workshop at the National Policy Conference in December 2000 and through the present publication. He oversaw the editing of this publication and also found time to contribute an original article.

Also deserving particular recognition are the authors who volunteered their time and energy to develop the articles that comprise this volume: Dan Ciuriak of DFAIT, Bruce Jamieson of the Department of Canadian Heritage, Philippe Massé of Human Resources Development Canada, Kerry David Max of the Canadian International Development Agency, Robert Stranks of DFAIT and subsequently Environment Canada, and Jake Vellinga of Health Canada. Equally, thanks are due to Professor Jagdish Baghwati of Columbia University and Gary Hufbauer of the Institute for International Economics, who graciously accepted invitations to lead seminars with the World Trade Issues Working Group and to have summaries of their remarks included in the present volume. And, of course, thanks are due to the many participants at World Trade Issues Working Group seminars, from both within and outside the Government of Canada, whose insights contributed to the development of the ideas articulated in the various articles.

Finally, I would be remiss not to mention the organizational support to the Working Group from Sushma Barewal, Vicky Edgecombe, Brigitte Diogo, and particularly Christine O'Connell; their efforts ultimately made this volume possible.

Hugh Stephens
Assistant Deputy Minister
Communications, Culture and Policy Planning, DFAIT
December 2000

Part I

Reflections on Trade Policy Post-Seattle



Trade and Coherence: A Roundtable Discussion

Dan Ciuriak (rapporteur)
Senior Economic Advisor
Trade and Economic Policy and Trade Litigation
Department of Foreign Affairs and International Trade

This note reports on a roundtable discussion of the complex set of issues under the rubric of "trade and coherence" held at the Department of Foreign Affairs and International Trade on January 21, 2000. Participants included invited experts on the global trading system, as well as the trade policy community within the Government of Canada. Following Chatham House rules, the views expressed at the conference are presented without attribution to individual participants. The usual disclaimer also applies: the remarks below are not to be attributed to the Department of Foreign Affairs and International Trade or to the Government of Canada.

The Context

In the wake of Seattle...

The causes and consequences of the failure of the World Trade Organization (WTO) Ministerial at Seattle in December 1999 to launch a new round of multilateral trade negotiations were not central themes for the roundtable but did not pass without comment. The outcome of Seattle obviously shaped the context for the discussions. As well, it necessarily serves as the point of departure for all considerations of next steps in process terms; ipso facto it determines the pace and modalities of progress on international trade and investment issues in the near term.

Moreover, the lessons learned from Seattle concerning the WTO (including its organization, capacities, procedures and interfaces with member governments, other international organizations, civil society and the general public) constitute important inputs to consideration of the various aspects of institutional and policy coherence in the world of trade. However, even if the Ministerial had not failed, the issues facing the international trade policy community would still be essentially the same – whether in the full glare of the public spotlight as currently or papered over through "constructive ambiguity" in the drafting of the communiqué and decision documents.

The exegesis of the causes of the failure ("whodunit") focusses on catalysts and accidental factors – the difficulties and delays from logistics; the long absence of executive leadership in the WTO during the preparatory process, which contributed to a poor starting point; the organized opposition from a broad swath of civil society organizations (CSOs); the disastrous atmospherics emerging from the media coverage; the absence of visible support from the business community (not to mention from CSOs whose concerns with development might have been thought to translate into support for new negotiations that were shaping up as a "development round"); the "bureaucratic" nature of the agenda, which may have explained the lack of interest of the business community;[1] and the many complications for the United States as host (which included the timing of the meeting vis-à-vis the domestic electoral cycle, the absence of fast-track authority, and so forth). In this context, the more fundamental difficulties proved

[1] The "bureaucratic" label is not meant to impugn the importance of the issues to the longer-term health of the trade system. Rather, it is meant to contrast the slow, institution-building nature of these issues, and the long gestation periods for development and implementation of solutions, with the rapid pace of change in the modern business environment, which does not allow corporations to wait for the working out of issues in the fullness of time and thus leads them to find other ways to achieve their ends – as indeed is attested by the rapid expansion of trade and investment notwithstanding the turmoil in the rule-making area.

impossible to overcome: these difficulties included the unhappiness of the developing countries with the negotiating process as well as the lack of evident benefits to them from the Uruguay Round; and the deep divides amongst the Quad partners (the United States, the European Union, Japan and Canada) and their preparedness to accept a failure rather than budge on key issues).

... unintended consequences of the Uruguay Round loom large...

A deeper understanding of the issues confronting the trade community today requires a look back to the Uruguay Round and some of its unintended consequences. In some views, what emerged from Marrakech was not so much the creation of the framework for a world trade system as the more or less wholly unprepared launching of a project for a single global economy. This pivotal – and unintended – shift was marked by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the incorporation of which into the WTO framework opened a Pandora's box of issues for the trade system.

Under the General Agreement on Tariffs and Trade (GATT), an implicit buffer had existed between international and domestic policy space – international regulations might constrain actions of governments but did not dictate the content of domestic rules. TRIPS, by setting out specific requirements for domestic regulation, breached this buffer.

Second, TRIPS established a precedent for using the trade system to deal with non-trade issues that were being addressed less than satisfactorily elsewhere. In the case of intellectual property, the inability of the competent body, the World Intellectual Property Organization (WIPO), to adequately enforce intellectual property rights at a time when trade in knowledge-based products was growing by leaps and bounds led to pressure (mostly from U.S. business) to deal with the problem through the trade system.

Third, the actual contents of the intellectual property rights agreement were negotiated within the trading regime's rule-making system. The embedding in the global economic system of certain values (specific rights for intellectual property) in this manner opened the way for pressure for similar embedding of other values – human rights, environmental safeguards, minimum labour standards and so forth – issues that had been dealt with in the international domain principally and for the most part ineffectually through hortatory agreements under the United Nations and other agencies.

In a similar vein, a view was put forward that TRIPS was not the only source of new complexities opened up by the Uruguay Round: pursuant to a mandate in the Marrakech agreement, the subsequently concluded Financial Services Agreement introduced, it was argued, the precautionary principle into the legal framework of the WTO. This opened the way for its application in areas where there were realistic hopes for science-based checks and balances, but also in areas where such hopes were slim given inherent longer-term uncertainties (e.g. genetic modification) and in areas where no such hopes existed at all (e.g. culture).

Management of the sorts of issues and tensions encountered when striking balances between different values and acceptable levels of risk is difficult enough at the nation-state level. Complicating matters hugely for the project launched by the Uruguay Round was that, due to success in bringing developing economies into the rules-based system, the single global economy was to emerge from a group of nation-states that differed enormously in their domestic regulatory structures. Some, principally in the Organization for Economic Co-operation and Development (OECD), were in the midst of the Thatcher-Reagan revolution, whose objective was characterized as the "withering away of the economic regulatory state." At the same time, these same states were refining complex social regulatory frameworks developed to, first, sustain long-standing social compacts that temper the distributional effects and social impacts of giving fuller rein to market forces; and, more generally, to manage the

technical/scientific, ethical and cultural/political issues of a technologically advanced society.[2] Other states, mostly outside the OECD, were not only resisting economic deregulation but were not embracing social regulation. Indeed, for the most part they lacked social compacts, not to mention the governance frameworks, technical capacity and domestic economic and political incentives needed to create and effectively implement such a regime.[3]

...and the WTO must deal with the problems that have grown out of its successes

The WTO that emerged from the Uruguay Round to guide and nurture the evolution of the single global economy had a much larger membership than the GATT (since grown to 135, with a list of 30-odd applicants waiting in line) and faced a widespread desire to resolve issues in other areas through WTO mechanisms. Although these are problems of success and not of failure, in the view of some, the challenges they posed overmatched the minimalist and legalistic structure of the WTO and its resources.

First, the accession of a large number of developing countries to the WTO extended trade rules to the clientele of the World Bank at a time when, based on the lessons from the "Asian Miracle" (which had firmly established that trade and investment were key engines of economic development) the World Bank was making trade and investment central planks of its development programs – and in effect was becoming a trade facilitation body.

---

[2] Between the 1960s and the 1990s, social regulation in the OECD experienced an "inflation" of 300-400 percent. While some bemoan this, as the connotations of the term "inflation" suggest they might, others see it as necessary, in that as the domain of the market expands so does the state's welfare role.

[3] New entrants (China, Russia, et al.) will not simplify matters in this respect – rather the converse.

Second, by 1999, as a result of the growth of foreign direct investment, sales of foreign affiliates surpassed the volume of cross-border trade, making the latter mode, for the first time, the junior partner in international commerce. In this context, distinctions between trade policy and broader economic policy (i.e. investment rules, subsidies, competition policy, etc.) become murky, if not totally collapsed (as they are in the case of trade in services); moreover, the institutional contest over trade rules takes on new life. And then along comes electronic commerce...

Third, the sheer growth in trade in relation to overall economic activity had qualitatively changed matters. At one time, trade accounted for about 7 percent of global production; in effect this represented the exchange between essentially *independent* economies of relatively small (percentage-wise) quantities of excess national production. Now, when trade accounts for about 25 percent of global production, it occurs between *interdependent* economies. Trade issues accordingly move from the periphery to the centre of overall economic policy and thus to the domain of institutions such as the International Monetary Fund (IMF) when problems arise, and more generally to domestic economic policy agencies, where trade disciplines are liable to be viewed as infringing on sovereignty.

The Issues: Institutional Aspects of the Trade and Coherence Agenda

What governing structure does the global market require?

The present systemic requirements clearly go beyond adding a few "bells and whistles" to the GATT/WTO system. However, the answer from Seattle to the question of what changes should be made to the global governance structure was essentially "we don't know yet." Absent a consensus on a grand plan, and attention then returns to practical problems.

The trade system may be unsustainable if it does not address labour, environment and human rights; at the same time, the trade system cannot do the "heavy lifting" on these most difficult issues.

A warning sounded by UN Secretary-General Kofi Annan a year before Seattle concerning the risks to the sustainability of the trade system if it did not somehow address the labour, environment and human rights issues apparently had some prophetic force. While the reaction against trade and the desire to "piggyback" the "values" issues on the WTO might seem mutually contradictory impulses, they can be reconciled: their common root cause is the lack of effective action on the values issues in the face of effective management of trade issues. It was suggested that the pressure to use the trade system to deliver results in these other areas will be harder to resist because of TRIPS – if the WTO can negotiate and enforce intellectual property rights, why can it not help enforce the Montreal Protocol in the case of the environment, or labour rights on behalf of the International Labour Organization (ILO)? The options for doing this would range from simply extending a blanket waiver for trade retaliation (as can be done for violation of internationally agreed standards), to bringing agreed standards into the WTO, to actually negotiating the standards, as was done in the case of TRIPS.

To some this is an alarming trend as it threatens to overwhelm the WTO, which is in difficult straits following a protracted period without leadership and an ill-prepared and ultimately failed Ministerial, in disarray over procedures (reform of the "green room" process, involvement of CSOs), and facing expectations in terms of analytical work, consultation and co-ordination, capacity-building assistance and surveillance well beyond its resources.

One logical framework that suggests itself is a partnership between the WTO and other institutions involved in regulation of international commerce, including the UN in cases such as the law of the sea, civil aviation authorities, the International Telecommunications Union, the ILO and so forth. Strengthening the partnership between the WTO and the UN was in fact

suggested by WTO Director-General Mike Moore in a presentation to the UN on January 19, 2000. Such a relationship would recall the historical ties between the WTO and standards-setting organizations; to the extent that the UN could broker a consensus, it would not be difficult for the WTO to recognize it. Similarly, the WTO could benefit from the resources and knowledge of the IMF and World Bank in its surveillance function[4] (although the spectre of the cross-conditionality to which this might lead creates considerable nervousness in many countries – notwithstanding the limitations placed on cross-conditionality at Marrakech). If one thinks of the WTO's functions as divided into "hard law" (e.g. administering dispute settlement, TRIPS, etc.), "soft law" (procedures, implementation, etc.), capacity building and surveillance, this approach would have the WTO concentrate heavily on the first role while looking elsewhere for support for the other roles.

A second way forward is the Global Compact being advanced by the UN; this initiative is attempting to opportunistically take advantage of the pressures on the business community to respond to the "values" issues in a spirit of voluntarism.[5]

Fortunately, the "hard economics" do not necessarily pose obstacles to progress in reconciling labour and environmental issues with trade. As was in a sense rediscovered in the course of

---

[4] This is very much in the spirit of the Integrated Framework, although the implementation of the latter has left something to be desired. For example, the World Bank supports programs for customs, but not necessarily the aspects that would be of interest or value to the WTO (e.g. in customs valuation).

[5] The notion promoted by Jagdish Baghwati of "behave abroad as you do at home" envisages actors with established "economic rights" sharing the burden of development in these areas. Much regulation (typically of a positive nature) is in any event private sector driven; the state usually enters to introduce the negative, "thou shalt not" type of regulations, often in cases where the precautionary principle would apply. The OECD is currently preparing a survey of the extent of self-developed standards in the private sector. While this is promising, it was argued that it will be important that a strong base of homework be done before the issues are brought to the WTO.

the Asian Crisis, addressing labour issues (e.g. through training and provision of social safety nets) assists in curtailing the decline of demand during downturns, helping to stabilize economies. In a similar vein, the higher incomes generated by economic growth generate demand for a cleaner environment as well as the wherewithal to achieve it. The question really is how to initiate these virtuous circles.

Is institutional coherence – in the sense of negotiated clarity as to roles and responsibilities – a realistic proposition?

Much has been made of the written agreement between the IMF and the World Bank as an example of how to generate institutional coherence amongst the international institutions. However, in its practical application, this agreement was described as being less a means of co-ordination or harmonization of policies than a minimal check on working at cross-purposes. Effective burden sharing is less a question of formal agreements on paper than a sense of ownership of the issues by the institutions involved.

Indeed, this reflects a more general feature of societies, which function largely on the basis of protocols that are not written down but understood and accepted.[6] Attempts to write these protocols down would be counterproductive, if at all possible. Accordingly, negotiated clarity as to which international institution does what with which clients in which circumstances is simply not realistic, especially since the set of "trade and..." issues is turning out to be much larger and more complex than was previously thought.

One metaphor that has been suggested to capture this sense of "bottom up" order – order generated not through centralism but rather pluralism[7] – as the basis of essential coherence is "rhythm"

---

[6] The notion that post-Westphalian nation-states function largely on the basis of formally developed rules is to some extent a myth; shared values and unwritten rules play a large role.

[7] This concept contemplates the citizen's – and by extension, the CSOs' – participation in national life above and beyond the act of voting in elections.

(a sense of being in step with the times, alert to developments and opportunistically prepared to engage co-operatively but with no more overt co-ordination than occurs, say, amongst couples on a dance floor or in a jazz band in full improvisational flight).[8] A practical example in the trade policy area might be to involve organizations and groups such as the ILO, the World Wildlife Federation and cultural associations in a country's Trade Policy Review Mechanism (TPRM) reviews, allowing them to comment on a country's policies, progress on implementation of trade-related commitments in their areas of concern, and so forth.

The Issues: Policy Aspects of the Trade and Coherence Agenda

Trade and development: shifting from "putting development into trade" to putting trade into development...

The "old formula" of putting development into trade through special and differential (S&D) measures has not only created a mess in the WTO, it was argued, but has failed in its purpose. It has not worked well for the developing countries, and such benefits as it delivered are eroding over time as the value of preferences falls with the general decline in tariffs worldwide. This experience, coupled with the success of trade-led development in East Asia, has led to a shift in thinking to emphasize trade

---

This, it was argued, is the sound basis for CSOs' participation in international forums, rather than the notion that they represent interests or values. At the same time, clarity is needed concerning roles (e.g. CSOs can participate in the discussions but, in governmental forums, the governments decide), and questions need to be addressed concerning advocacy by CSOs. As a historical footnote, such participation is also far from new: as was pointed out, CSOs were involved in the League of Nations.

[8] This concept is developed in Robert Wolfe, "Rendering unto Caesar: How Legal Pluralism and Regime Theory Help in Understanding 'Multiple Centres of Power.'"

facilitation as part of development policy (e.g. in the Comprehensive Development Framework and the Poverty Reduction program).

Trade and finance: the WTO is prepared to liberalize financial services, but the IMF emphasizes prudential regulation...

The WTO is ready to proceed with financial services liberalization; the technical support is in fact in place. However, the institutional and policy interface issues raise significant difficulties. The financial services agreement in the WTO was made possible only by carving out the supervisory aspects; the IMF now wants to ensure that financial liberalization proceeds only in the context of adequate supervision and regulation ("proper sequencing" is the phrase of finance ministers), a response to the view that the Asian Crisis was due to liberalization of financial markets in a context of inadequate regulatory and supervisory systems. Moreover, there is a structural issue given that a country can renege on commitments under the General Agreement on Trade in Services (GATS) for two reasons: balance of payments difficulties or at the request of the IMF.

Trade and investment

The growth of foreign investment and the absence of business support for the Multilateral Agreement on Investment (MAI) beg the question: where is the market failure that creates the need for a multilateral instrument on investment? Perhaps, indeed, there is no market failure – firms are finding a way to deal with the issues that affect them.[9] Moreover, the GATS is an effective instrument for

[9] Indeed, given the fact that business can use regulatory arbitrage to obtain favourable conditions for investment, not to mention the length of time it takes to negotiate and implement an agreement compared to the time horizons in which business decisions are made, it is an open question why business would ever support a multilateral instrument that would minimize the scope for such

liberalizing services trade, which is where investment liberalization really matters.

Nonetheless, concerns about the functioning of the system might lead one to conclude that the present messy patchwork quilt of bilateral Foreign Investment Protection Agreements (FIPAs), etc., needs to be replaced by a sound multilateral framework – if only to lock in the current comparatively liberal regime for global investment. In this case, the big challenge will be to address services.[10] Since states do not necessarily want to be constrained in competing for direct investment (or policy freedom more generally),[11] consideration would also have to be given to the content of a multilateral investment agreement. As well, what would the "architecture" be? For example, could a "variable geometry" regime work (as in the case of the Telecommunications Agreement, where the "critical mass" approach worked and did not undermine the single undertaking)?

Given that multinationals tend to look at their operations in regional terms, a second approach would be to consider developing regional investment frameworks. By levelling the playing field regionally, regional investment frameworks may be where the biggest "bang for the buck" will be.

A third consideration is dealing with the "demand" side of investment – addressing bribery and corruption. One might consider "migrating" the OECD guidelines on multinational corporations to Geneva. Extraterritoriality also remains an issue.

Trade and labour, environment, culture, etc.:
a complex new world...

---

arbitrage and not resolve any of the problems that it faces in the foreseeable future. At most, the small-business community might benefit.

[10] It can be noted in this regard that 91 percent of the NAFTA non-conforming measures are in services sectors.

[11] It was noted in this regard that economic policies such as Canada's National Energy Program would have been ruled out by an MAI.

The interface between the WTO and the regulation of international commerce more generally is not new. Indeed, at any given time, there are several *thousand* active committees under the International Organization for Standardization (ISO) alone, working on the technical nuts and bolts of the global economy. This activity is open to all states[12] and in many cases directly involves business (in some high-technology areas, such as telecommunications, the majority of the participants are corporate – and not simply in an advisory capacity, but as voting members), as well as civil society organizations (typically in an expert advisory capacity).[13] For the most part, this low-level activity has proved to be highly successful, and a well-established if informal protocol governs the relationship between the various actors: the international standards are set by the competent international organization and are recognized and deferred to by the WTO, with departures from international standards accepted to the extent that they are no more restrictive of trade than the internationally agreed norms. Nonetheless, when some of these issues get caught up in the trade system as technical barriers to trade (TBTs), jurisdictional issues are raised.

---

[12] Developing countries would be hard-pressed to participate meaningfully. While in one sense this is not especially problematic, since the subject matter tends not to be relevant to them (strength of bolts on airplane wings, etc.), in another sense it does raise questions of buy-in, since the standards are thus effectively set by developed countries, reflecting developed-country norms, legal frameworks for liability and social attitudes concerning risk. At the same time, there really is no flexibility to lower the standards since they would then lose their purpose for developed countries. The complications as regards technical assistance for capacity building are clear.

[13] Some less successful examples include the now largely lapsed attempts to regulate commodity prices internationally through commodity organizations under the UN Conference on Trade and Development (UNCTAD); an echo of this is the continuation of some activity by the World Bank in managing the global commodity futures market.

As noted, the TRIPS agreement has opened up new possibilities for the WTO's role in the regulation of international commerce – if the WTO can negotiate and enforce intellectual property rights, why not the Montreal Protocol in the case of the environment, or labour rights on behalf of the ILO?[14] The options for the WTO would widen from simply extending a blanket waiver for retaliation (as can be done at present for violation of internationally agreed standards), to bringing agreed standards into the WTO (stating what can and cannot be done in the area), to actually negotiating the standards as in the case of TRIPS.[15]

One major complication looming over this whole range of issues is the precautionary principle: absent overwhelming scientific justification for standards, and issues turn on questions of consumer choice and different levels of risk aversion across societies – and in the case of culture, questions of what makes us "us." There have been some successes in handling this class of issues in the WTO – the French scallops case in the WTO provided an example of how to deal with the precautionary principle through voluntary labelling. However, in some views, given the potential for abuse,[16] the precautionary principle is a ticking time bomb[17] that urgently needs to be addressed – perhaps by redressing a glaring weakness in the international institutional framework from the failure of UNESCO to provide an authoritative voice on science and technology issues, as it

---

[14]This leads some to contemplate throwing out the TRIPS agreement, and the GATS for good measure, in order to preserve the rest of the trade system.

[15] It was noted that the WTO text at Seattle would have resulted in holding to past practice (i.e. standards simply being recognized by the WTO).

[16] Credibility has already been strained by its application in circumstances that raise strong suspicions of cheating.

[17] Indeed, a time bomb that may already have gone off, as evidenced by the call for a World Council on Food Safety. The OECD is doing work on behalf of the G-7 on this issue, and the issue is receiving attention in environmental policy circles as well as elsewhere.

originally was conceived to do. Probing this set of issues generally returns us to the issue of how to define the buffer zone between international and domestic policy – in the end there are legitimate questions of social choice (community involvement and the building of trust and credibility) that cannot, as it was put, "be resolved by appeal to unaccountable people in white lab coats."[18]

For the WTO, this might mean having to improve its interfaces with labour (ILO), environment (UN Environment Program, or UNEP) and health groups.

From a practical perspective, where is there scope for progress on trade issues?

For Canadian business, trade problems are principally seen as lying in the bilateral trading relationship with the United States, and this is where it was suggested that the government will find resonance for its initiatives. Nonetheless, there would be merit in promoting a deeper understanding within the business community of the extent to which it is the multilateral system and its rules that help make the NAFTA regime robust.

More generally, the regional front needs attention, at least in the Americas, where there has been little progress in the Free Trade Area of the Americas (FTAA) process on delivering the basic bargain made at Miami (market access for democratization). Moreover, this bargain is in fact becoming harder to fulfil given a steep rise in pressures on Latin American countries to live up to North American standards in terms of labour and the environment, while movement on the economic (market access) front has yet to materialize.

---

[18] In fact, as in the case of the Charlottetown Accord, there are instances where all the experts agree but the public goes against the expert view.

One area where practical problems face the trade system today is frictions over processes and production methods (PPMs). Some of the most important work underway today is to address these problems through mutual recognition agreements (MRAs) that smooth the way for trade, without fanfare but in ways that matter very much to the business community. For business, therefore, the "new coherence" issue turns out to be the "old coherence" issue.

On standards, it was argued that the emphasis needs to shift from product specifications to performance specifications. At the same time, because performance specifications are looser, it is important that there be confidence in certification – hence the need for a competent international certification body presiding (which could directly involve CSOs, as in the case of forest products, where CSOs help set standards).

This of course does not gainsay the need for governments to address the longer-term governance issues facing the globally integrated economy – even if these issues, which for the most part revolve around points of bureaucratic conflict and therefore are of interest primarily to public officials, are ignored by the business community.[19] Many of these issues (e.g. improvements to the dispute settlement mechanism) do not require a "round" and could be addressed on an incremental basis.

That being said, some problems (e.g. agricultural subsidies) may defeat consensus, requiring a broader range of issues to be put on the table in order to provide the basis for trade-offs. In short, a round might be needed, although there is no agreement yet on what the shape of the next one would be.

---

[19] Nor does it gainsay the desirability of greater engagement in this endeavour by those in the business community who have the ability (and the luxury) to look beyond the next quarterly profit statement.

Summary and Conclusions

First and foremost, Seattle was the not-unprecedented failure of a trade Ministerial, not of the trade system itself. There continues to be a rapid expansion in the exchange of goods and services internationally as well as in investment flows.

Second, the WTO faces major institutional challenges:

- it needs substantially strengthened resources;
- its internal structure needs to be reformed; in particular, the "green room" process needs to be replaced with a viable executive committee that is transparent, legitimate, negotiated and agreed; and
- a reasonable balance needs to be struck regarding which issues migrate into the WTO versus those that are kept at arm's length – a pure WTO is probably as unlikely to emerge as one that becomes a receptacle for every issue that comes along; the WTO's interfaces with other key international institutions (e.g. the ILO, UNEP, UNESCO and others) need to be developed accordingly; and consideration needs to be given to possible new institutions (e.g. a World Environmental Organization).

Third, recognizing that reforms to the WTO only scratch the surface of the problems, other institutions such as the World Bank have to shoulder some of the burden being placed on the WTO, especially in respect of "getting trade into development."

Fourth, there is a need to renegotiate the boundary or buffer between the international regulation and domestic policy space. How this might be done clearly deserves some considered thought.

What It Will Take to Get Developing Countries into a New Round of Multilateral Trade Negotiations

Jagdish Bhagwati
Columbia University

This note summarizes comments on the set issues under the rubric of "trade and development" by Professor Jagdish Bhagwati of Columbia University at a seminar organized by the World Trade Issues Working Group at the Department of Foreign Affairs and International Trade in March 2000. The usual disclaimer applies: the views presented at the seminar and reported here are not to be attributed to the Department of Foreign Affairs and International Trade or to the Government of Canada.

The North-South divide that was fully exposed at the World Trade Organization (WTO) Ministerial meeting in Seattle in December 1999 was one of many factors that contributed to the failure to launch a new round of multilateral trade negotiations at that time. Since the world trade system works by consensus, the developing countries have to be brought onside in order to achieve the launch that ministers, trade officials and the WTO are actively working toward. The following are some key elements of a framework that would work for the developing countries.

Developing countries are now major players and must become full parties to the "give and take" of trade negotiations

The concept of different economic systems for developing versus developed countries (special and differential measures, in the parlance of trade policy) has essentially been discredited: it is now understood that there is a single economics for all. Institutional differences must be taken into account when applying this same economics; the developed countries, however, are looking for some reciprocity. By implication, developing countries will not get a "free lunch."

Indeed, one reason why the trade system has not worked all that well for developing countries (some countries have "graduated" while others have regressed) was that they never did have much of a free lunch. The system of consensus on a most favoured nation (MFN) basis works against those who make no concessions; thus the developing countries that offered little got little. For example, key markets such as textiles and agriculture remain subject to tight restrictions that are only now being incrementally eased as a consequence of the Uruguay Round.

It is essential that developing countries come to accept that their future participation in trade will depend on an exchange of mutual benefits – in other words, they must be fully part of the "give and take" of trade negotiations.

The expansion of trade rules in the Uruguay Round to include "inside the border" measures is perceived as a threat by developing countries. Their fears are amplified by the way in which non-governmental organizations and others in the developed countries, including some governments, have framed the issues

There is first a need to understand that this perception exists and that it needs to be addressed. The concept of general equilibrium shows that everything is eventually related to everything else. This

is not very helpful, however, and some lines will have to be drawn as to what is trade and trade-related policy – and what is not. Several, if not many, of the issues that have been brought into the realm of trade policy issues are in fact broadly *trade-unrelated.* Continuing to deal with them in a trade context is damaging to the cause of getting developing countries to support a new round.

The Trade-Related Intellectual Property Rights (TRIPS) agreement concluded in the Uruguay Round was the first intrusive element and has had many, largely unanticipated, consequences. On the economics of the issue, while there is arguably some limited need for patent protection, the evidence does not show much of a supply-side effect on production from intellectual property rights protection.

Moreover, TRIPS does not involve mutual gain; rather, it positions the WTO primarily as a collector of intellectual property-related rents on behalf of multinational corporations (MNCs).[1] This is a bad image for the WTO and in the view of many, especially the non-governmental organizations (NGOs), reflects the "capture" of the WTO by the MNCs.

Several high-profile cases in recent years have entrenched this perception among NGOs and underpin their claim that the WTO should do the same for nature, human rights and other causes. At present, the General Agreement on Tariffs and Trade (GATT), General Agreement on Trade in Services (GATS) and TRIPS form a tripod within the WTO. But the tripod threatens to turn into a centipede as other issues are introduced. It is scarcely surprising, given the way that the NGOs frame these issues – the name of the game being to encourage the use of trade sanctions to advance their agendas – that they are perceived as threats by the developing countries, undermining for them the traditional perception of the WTO as a safeguard for the weak against the large players within the trade system.

---

[1] This and other concerns emanating from the WTO's role in trade disputes have led some to consider the creation of a World Trade Court or to advocate shifting the Dispute Settlement Mechanism to the International Court.

In particular, labour and social issues need to be separated from trade sanctions – indeed, they need to be moved completely out of the trade picture. The United States and European Union pushed for a working party at the WTO Ministerial; however, while the U.S. was saying that this was "not a foot in the door," the developing countries saw it as "two feet in the door." President Clinton's statement that trade sanctions *were* in the picture had an electrifying effect on developing countries in Seattle.[2] To get developing countries into the trade round, children's/workers' issues, legitimate as they are, need to be clearly moved to the International Labour Organization (ILO), where they can be addressed without the threat of trade sanctions.[3]

Environmental issues are quite different from labour issues: all sorts of environmental issues are now being dealt with in the WTO; the developing countries need to engage on them

---

[2] The U.S. action was highlighted on the day of the NGO meeting in Seattle. The 1930 Trade and Tariff Act was used to take this issue to the WTO; if it gets into the WTO and the WTO strikes down the U.S. action, it was argued that the NGOs will use this as ammunition to say that the WTO is pro child labour.

[3] Trying to get at the child labour issue in South Asia via trade is counterproductive – an OXFAM study in Bangladesh showed that a ban on child labour drove girls into prostitution. It was argued that the World Bank and International Monetary Fund should also remove themselves from these issues; indeed, even UNCTAD [UN Conference on Trade and Development] is difficult for developing countries because of the "T." The way to go is via ILO programs to get children into school. Apropos this issue, the fact that the United States is not signatory to many ILO conventions is not a sign of non-engagement, but simply a reflection of the fact that the U.S. does not sign on to promises that it cannot deliver on – unlike many countries that sign everything and can deliver little. One reason for this is the very complex institutional setting. The U.S. ratification process is very difficult and, moreover, there are private enforcement mechanisms in the U.S. not available in other countries.

For better or for worse, environment is well established in the WTO. The Dispute Settlement Mechanism is already pronouncing on the issues, and developing countries cannot afford to be on the sidelines. Of particular concern to the developing countries is that processes and production methods (PPMs), which experience has shown can be used for trade protection purposes,[4] have been addressed within the context of the Dispute Settlement Understanding (e.g. the shrimp-turtle decision), although it is an open question whether issues such as those surrounding PPMs should be negotiated rather than litigated within the WTO.

Having environment dealt with at the WTO raises many issues – in particular, the compatibility of trade rules and the environment accords needs to be sorted out. At a minimum, a grandfathering approach needs to be established. This is an argument to get developing countries into negotiations because they stand to lose if judges and other legal experts are left to decide the issues in the WTO.

Keep investment policy low-key and competition policy on the back burner

The effort to negotiate a Multilateral Agreement on Investment (MAI) in the OECD touched raw nerves; this is a good time to keep investment issues low-key. At the same time, some sense of stakeholder commitment is needed from multinational corporations; having no obligations on MNCs is inconsistent with where Western societies are heading.[5]

---

[4] See, for example, the famous case of Swiss restrictions on German cheese, which were based on processing requirements but were transparently protectionist in intent. A description of the shrimp-turtle case may be found on the WTO website (http://www.wto.org/english/tratop_e/envir_e/edis00_e.htm).

[5] However, pushing for "living wages" is not a good way to go – this benefits those already with jobs in the developing countries, not those on the outside looking in.

This issue, and competition policy as well, is being pushed primarily by the European Commission without an apparent or clear political rationale.

Democratic deficit: transparency concerns need to be sorted out from the issue of representation

There are three elements to the concerns about the democratic deficit: negotiations, dispute settlement and everyday work. There is no problem with letting the world see what goes on in the WTO, including in the dispute settlement process. The WTO should open its doors, but NGO observer status and/or direct participation are false issues. The democratic deficit issues need to be sorted out because developing-country positions have hardened against NGO participation in negotiations following Seattle.

Implementation and an early package for developing countries are important to facilitate the process – but how it is done is just as important

The position of the International Monetary Fund/World Bank paper on trade and development – which proposes free market access for products from heavily indebted poor countries (HIPCs) – is problematic in that it risks simply shifting limited market access around amongst the poor rather than creating significant new market access for less-developed countries as a whole.[6] As

[6] This is one aspect of a larger problem: trade is mutually beneficial provided it is non-coercive – this is true for the trading partners directly affected, but how about for third parties? Major initiatives such as the Uruguay Round have an impact on marginal countries, and that is where the international financial institutions should come in. The bananas case showed how an E.U.-U.S. dispute can affect mainly Caribbean countries, but the World Bank did not take a leadership role on their behalf.

usual, textiles are the key. As for trade-related technical assistance (TRTA), ultimately countries have to fend for themselves.

If the developed countries are looking for appropriate signals, call the next negotiations a Development Round – and consider Delhi as the site to launch it.

Trade and culture

America is different. A key difficulty for the world community is the way the United States approaches culture and thus how to deal with the U.S. on this issue multilaterally. The United States does not see cultural imports as a threat; indeed it imports and absorbs culture from everywhere. Moreover, the U.S. is a "pill popping" culture – hence its relaxed view on genetically modified organisms (GMOs). By contrast, European fears of GMOs reflect cultural proclivities. Accepting that cultural diversity is a good thing, alternative ways need to be found to protect culture, since restrictions on market access will not work. Ultimately it is not desirable to dictate to consumers what they should see or read – subsidies, for example, can be used effectively.

Impact of Chinese accession to the WTO: entry of China will be good, and the WTO will be the "bull in the china shop"

China's accession will be beneficial from many perspectives. Not least, it will remove China from U.S. special considerations. As the U.S. actions on Russia's steel exports showed, the United States itself will benefit from having to play by the rules, in that this prevents arbitrary actions harmful to its own constituents.

But China will be hard to move (it is the proverbial 800-pound gorilla) and so progress will be slow even after accession. The point is to get it moving in the right direction. In this respect, the WTO could well be the "bull in the china shop" that helps move it down the right path. For the developed countries, the best policy

otherwise might be described as the "open mouth" policy – be a "mosquito in the ear" that keeps putting the message incessantly.

Other issues

GATS safeguard mechanism: Acknowledging that a safeguard would facilitate entry into wider commitments by developing countries in the services area, it is difficult to think of a suitable mechanism – a standstill was one idea advanced. This issue was widely discussed in the Uruguay Round without resolution.

Agriculture and multifunctionality: It is hard to see how this argument can be considered consistent with free trade. There are alternative mechanisms to achieve stated goals.

Conclusions

The WTO needs to have a mix of policy, law, economics and political/diplomatic input to be successful. The transparency issue is real and the WTO needs to be forthcoming; NGO representation is not a real issue. Some issues, if included in the framework of trade negotiations, would be "poison pills" for the developing countries and as such would prevent the launch of a new round. Labour and social issues need to be dealt with in other forums. Investment and competition policy should be put on the back burner. Developing countries need to engage on trade and environment as it is currently playing out in the WTO. However, it is not clear that what is left on the table creates the basis for broad-based or comprehensive multilateral trade negotiations.

Trade and Coherence: Where the Major Gains Lie

Gary Hufbauer
Institute for International Economics

This note summarizes the commentary by Gary Hufbauer, Senior Fellow at the Washington-based Institute for International Economics, on the evolution of thinking as to where the major gains in the trade and coherence debate lie, and where governments should be placing their priorities, at a seminar organized by the World Trade Issues Working Group at the Department of Foreign Affairs and International Trade in April 2000. The usual disclaimer applies: the views presented at the seminar and reported here are not to be attributed to the Department of Foreign Affairs and International Trade or to the Government of Canada.

The case for globalization is strong. Poor people benefit from growth, percentage point for percentage point, and trade is vital for growth.

No proposition in economics is indisputable, but one that comes close is the tight positive correlation between growth in trade and growth in GDP. At the same time, there is a strong positive relationship between growth in GDP and growth in incomes of the poorest. Income disparities between the richest and poorest countries have tended to widen. Nonetheless, the relationship is roughly one-to-one within countries (whether rich or poor) between the growth rate in the per capita incomes of the lowest quintile of the population and the overall GDP growth rate. The exhaustive work of David Dollar and his World Bank colleagues merits the attention of everyone interested in the inequality issue.

While the trade-growth link is strongly supported by numerous studies, the econometric evidence is less clear about whether capital flows cause stronger growth. Examining the uneven performance of economies around the world, a case can be made that financial depth (the size of the combined banking, insurance and securities sectors in an economy relative to GDP) is linked to good economic performance. I mention the work of Ross Levine, Joseph Francois, Wendy Dobson and Pierre Jacquet. Wendy Dobson and I are now doing some speculative calculations on the benefits of capital flows to emerging countries, as well as the costs of financial crises. I should note, however, that econometric work by UNCTAD is equivocal on the connection between foreign direct investment and economic growth – cause or effect?

Since 1980, there has been a massive growth in trade and substantial improvement in the welfare of the majority of the world's population, especially in East Asia where the most rapid growth in trade took place. This growth has benefited four billion of the six billion people on the planet. However, two billion people continue to live in extremely poor circumstances. The worst economic performance is associated with hyperinflation and political chaos.

Even successful countries must cope with severe internal tensions

The successful countries have given up trying to achieve income equality in the Fabian sense of funding massive programs for the lowest quintile by heavy taxes collected from the rich. Instead, they accept the trade-off between overall growth within a market economic framework and the fact that some people will become very rich indeed.

Nevertheless, technology-driven wealth is generating envy and backlash. In the past, wealth was largely created by thrift, hard work and commanding leadership – puritan virtues. Today, wealth is created by brilliance. This is a big difference. Although the causal links between great wealth and

globalization are hazy, a good part of the backlash is directed at the global economy and international institutions.

Even in the successful countries, there remains a strong public yearning for rough equality in health care. But technology-driven health care improvements are driving a significant wedge between the health care available to the rich and the care available to the poor or even the middle class. The widening of disparities of income and wealth in the era of information technology has been grudgingly tolerated by most market societies; widening disparities in health care may be accepted less easily. Coupled with ageing in all the industrial countries, the new health technology promises astounding increases in public budgets. It remains to be seen how this force affects the debate on globalization.

Meanwhile, the international institutions are losing public support

The basis of support for the international institutions is eroding due to the "democratic deficit." "Y'all come" rhetoric that aims to co-opt civil society organizations (CSOs) by involving them in the work of the international institutions is not working. The World Bank made the greatest effort in this direction and was the most heavily attacked in the April 2000 demonstrations in Washington.

Moreover, the co-option strategy is questionable because there is a severe problem of choice concerning the CSOs. Which ones speak for the public? At the national level, there are well-established processes for engaging civil society in developing policy (at the same time, it is notable that governments do not permit CSOs or other lobbyists into Cabinet meetings or give them a vote on legislation).

One possible way to address the democratic deficit problem is to involve parliamentarians, selected from appropriate parliamentary committees, in the international institutions. These men and women have gained legitimacy by standing for election and are involved in the issues. They could play a

greater "oversight" role in the work of the international institutions. Perhaps the OECD could serve as the initial vehicle for trying this idea out.

In the current environment, there is a premium on practical versus visionary work and on narrowing the focus of the international institutions that have wandered afield from their mandates.

The World Trade Organization

The WTO is about trade: liberalization, safeguards, and the various administrative and legal instruments, including most importantly the Dispute Settlement Understanding (DSU). The WTO is broadly effective, notwithstanding the fact that some issues (such as the controversy over genetically modified organisms) will likely prove too large to be handled through the DSU. It is important that the WTO focus on trade. Recalling the percentage-point-for-percentage-point gains in income for the poor from trade-led growth, bringing down market access barriers in developed countries is a priority.

Two issues that some are urging be introduced into the WTO are "poison pills": environment and labour. In the Uruguay Round, the WTO probably went too far in incorporating intellectual property rights (particularly in the case of pharmaceuticals) into the core of the trade regime. The TRIPS agreement continues to elicit an adverse reaction from developing countries. Moreover, it paved the way for CSOs in industrial countries to urge that environment and labour concerns be added to the WTO agenda. These issues need to be addressed in a different manner.

Labour issues, for example, need to be handled through the International Labour Organization (ILO). The ILO is in a revival phase. It has enforcement mechanisms in its articles, although these have never been used. They could be used to advance the agenda on "core" labour standards. Other mechanisms could be developed or used in this connection:

- Civil sanctions are available in some countries.

- The ILO could "rate" the regulatory framework for labour standards.
- A labelling system could be developed that would allow consumers to distinguish between products in terms of the labour conditions under which they were produced. Firms that have better working conditions could cite their adherence and increase their market share.

By contrast, environmental institutions are weak and operate in a fragmented framework. There are few truly global environmental issues; in fact, at present there may be only two: ozone protection and global warming. Most issues are largely national in scope – rain forests, endangered species, waste disposal, and so forth. In the environmental area, we need imaginative thinking on ways to advance the agenda that do not entail trade sanctions. Some of the approaches I have outlined for labour standards may be applicable in the environmental realm.

There are two other emerging issues facing the international economy that may involve the WTO: e-commerce and competition policy. The WTO could attack the thick underbrush of issues (taxes, customs procedures, etc.) that need to be cleared away to allow e-commerce to develop efficiently. The recent wave of cross-border mega-mergers raises troubling questions. What are their long-term competitive implications? The starting step might be a United States-European Union agreement to establish a basis both for approving future mega-mergers and for monitoring the market outcomes.

The World Bank

Of the international institutions, the World Bank has been the worst offender in terms of wandering far afield from its mandate. While it has a good image (testimony to effective public relations work by its leadership), it is organizationally a disaster (with layer upon layer of management). It tries to do too much for too wide a range of countries.

The World Bank needs a major shift of emphasis. In middle-income countries, it needs to concentrate on the bottom

20 percent of the population. For the 1.5 billion people living in chaotic nations, the World Bank needs to build the civil conditions that are the prerequisite for economic growth. Typically, disasters arise following the seizure of power by a small group that subsequently pillages the economy. Re-establishing the basis for growth requires wholesale administrative change. The World Bank could work with donor countries to provide, on invitation by countries emerging from civil chaos, a cadre of administrators who would build the institutions necessary for effective markets – a judiciary, stock market and so forth. Basically, this prescription amounts to receivership for countries in the worst straits, nations such as Congo and Sierra Leone.

The International Monetary Fund

The call by the recently retired IMF managing director, Michel Camdessus, to recast the Fund as a poverty reduction institution is wrong-headed. It both conflicts with the World Bank's mandate and involves work that IMF staff members, who are more comfortable with central bankers, are not ideally suited to address. The IMF needs to focus on its role of crisis management and crisis prevention (including in the latter context making much better and more timely information available to markets and acting as the auditor for the auditors of banking systems).

Summits

Summits can be useful in two ways. First, they can help reduce security tensions – which can happen even in "photo op" summits, such as the Asia-Pacific Economic Cooperation (APEC) forum has tended to become. For example, there were significant benefits from the bilateral meeting between President Clinton and China's Jiang Zemin on the margins of the Auckland Leaders meeting in November 1999. Summits can also give direction to "line" institutions, especially when those institutions run into negotiating barriers.

Part II

The "Trade and ..." Agenda



Trade Liberalization: The Broader Context

Robert T. Stranks
Department of Foreign Affairs and International Trade

This paper was presented at a World Trade Issues Working Group seminar at the Department of Foreign Affairs and International Trade in September 1999. It builds on an earlier paper prepared for the APEC Economic Committee, The Impact of Liberalization: Communicating with APEC Communities *(APEC Study Centres Network and PECC Consortium for APEC, November 1998). The usual disclaimer applies: the views presented at the seminar and reported here are not to be attributed to the Department of Foreign Affairs and International Trade or to the Government of Canada.*

This paper provides an overview of trade liberalization and its interface with a number of contemporary issues and concerns. It consists of six sections: The Rationale for Trade and Liberalization; What Is Liberalization?; Trade and Policy Coherence; Trade and Adjustment; Trade and the Environment; and Liberalization, Governance and National Sovereignty. Each of these sections aims to bring out the linkages between the issues and the complexity of conceptualizing and assessing how liberalization impacts upon our lives.

The Rationale for Trade and Liberalization

The economic benefits of trade and trade liberalization are widely recognized. By improving the allocation of factors of

production, trade is an important contributor to economic welfare.[1] Trade allows economies to move beyond domestic production possibilities and constraints, and in so doing to provide a higher standard of living than would otherwise be the case.

The benefits of trade can be illustrated with an intuitive example. Consider two economies: Korea and Indonesia. Korea has no domestic oil production and requires imported oil from Indonesia, or from other oil producers, to sustain its economic activities. Without this oil, the standard of living in Korea would fall. Conversely, Indonesia demands a range of consumer and capital goods not produced domestically, thus requiring imported goods from Korea, or from other goods producers. Without these goods, the standard of living in Indonesia would fall. Trade thus is beneficial to both of these countries.

Another way of understanding trade is to think of it as a technology for the production of goods.[2] Let us say there are two technologies for the production of cars in Canada. The first technology involves the physical production of cars in factories in the province of Ontario. The second technology involves growing wheat in the province of Saskatchewan and subsequently exporting this wheat to Japan in exchange for cars produced in Japanese factories. While the two technologies differ in respect to inputs used, the final result is the same: Canada has the cars. Consequently, whether Canada should use

---

[1] It should be noted that the logic for international trade and for domestic trade are the same (i.e. division of labour and specialization). This logic may also be applied to individuals and trade among individuals. Without trade, each individual would have to be self-sufficient, and consequently would have an extremely low living standard and short life span.

[2] This example is taken from Marc T. Law and Fazil Mihlar, "Debunking the Myths: A Review of the Canada-U.S. Free Trade Agreement and the North American Free Trade Agreement," *Public Policy Sources*, no. 11 (The Fraser Institute, 1998). This approach to understanding trade is taken from James Ingram, *International Economic Problems* (New York: John Wiley, 1966).

the first or second technology should depend on which one enables Canada to get the most cars (or to get the same number of cars with the least resources). Trade is like the discovery of a new technology that makes workers more productive.

The reduction or elimination of barriers to trade amongst countries encourages firms to produce and trade goods and services in which they have a comparative advantage. Economies will concentrate on goods and services that they produce efficiently, and trade these goods and services for what they produce less efficiently.[3]

Trade liberalization allows for the greater exploitation of economies of scale. By providing domestic producers increased market access opportunities, the freer market conditions enable firms to undertake specialized production runs that reduce the unit costs of production. For countries with small domestic markets, economies of scale may be extremely important. Economies of scale and specialization in specific product lines also explain why two or more countries may each produce and import and export a particular good, such as shoes. Each producer can have a specific market niche. This specialization in production, and the resulting increase in intra-industry trade (both imports and exports), however, implies change for the domestic industry.

Trade liberalization also increases competition in both the foreign and domestic markets. This implies that firms will need to respond faster to changing market conditions. Greater competition is likely to provide an incentive for firms to

---

[3] The gains from trade depend on the pattern of comparative, not absolute, advantage. Even if Country A can produce everything more efficiently than its trading partner (absolute advantage), it will still have an incentive to trade if two conditions are satisfied: (a) it can produce certain things more efficiently than others; and (b) its own relative efficiency in producing some things versus others is different than the relative efficiency of Country B in producing these same product sets. This leaves room for Country B to produce those products that it can produce relatively more efficiently. Thus both countries have a comparative advantage in producing some goods and hence gain from mutual trade.

improve their economic performance through cost-saving innovations and to enhance the quality of their products. More competition also leads to lower prices for consumers. The core message of a recent OECD study is that, on balance, trade and investment liberalization in the long term is beneficial to society. The study gives a balanced assessment of the strengths and weaknesses of trade, including drawing attention to the fallacy of the argument that "exports are good and imports are bad." Trade liberalization influences both imports and exports. Access to low-cost imports, for example, plays an important role in enhancing consumers' well-being, as well as allowing domestic firms to have access to competitively priced inputs.[4]

Finally, trade liberalization undertaken in a bilateral or multilateral context and which establishes clear trading rules will reduce uncertainty. Without such rules, a country may face unilateral, often damaging, actions from its trade partners. The reduction of uncertainty, while providing more stable access, will also allow firms to make more informed business decisions.

In short, an economy under autarky (i.e. one with no or limited international trade) that must domestically produce all that it consumes, forfeits the economic gains (and social benefits) that are realized through international trade. Trade, and the liberalization to make trade possible, is a positive proposition.

In an article addressing some myths and misconceptions of trade, Paul Krugman highlighted and summarized six points to consider in understanding trade:[5]

- International trade is an economic activity like any other and can be thought of as a production process that transforms exports into imports.

---

[4] OECD, *Open Markets Matter: The Benefits of Trade and Investment Liberalization* (Paris: OECD, 1998).

[5] Paul R. Krugman, "What Do Undergrads Need to Know About Trade?" *American Economic Review,* 83 (May 1993).

- Imports, not exports, are the purpose of trade. A country benefits from trade because of the ability to import the products it wants. Exports are not an objective in and of themselves: the need to export is a burden that must be borne in order to pay for imports.
- High productivity is beneficial, not because it helps a country compete with other countries, but because it lets a country produce, and therefore consume, more. This is true in a closed economy, and it is no more or less true in an open economy.
- Too much emphasis is put on "high value" sectors. Trade allows all countries to benefit, not only those specializing in the "high value" sectors.
- Employment is a broad macroeconomic issue, with policies, such as tariffs, having little net effect. Trade policy should not be debated in terms of "phony numbers about jobs created or lost."
- Government support of a specific industry may help that industry compete against foreigners, but it also takes resources away from other domestic industries. International trade does not change the fact that government cannot favour one domestic industry except at the expense of others.

What Is Liberalization?

To understand trade liberalization, an understanding of the characteristics and institutional context of trade is required. The focus here will be on the multilateral trading system. The most visible trade barrier is the tariff, but trade liberalization is much more than negotiations on tariff rates. Within a multilateral context, first with the General Agreement on Tariffs and Trade (GATT) and then with the World Trade Organization (WTO),

tariffs have fallen considerably over the past 50 years.[6] But other measures aside from tariffs, such as subsidies and government procurement practices, also affect trade. These have long been recognized as often having trade-distorting effects and requiring multilateral discipline.

The Uruguay Round of GATT negotiations, which resulted in the establishment of the WTO, expanded the multilateral trade rule framework to include such issues as trade-related investment measures (TRIMs), trade-related intellectual property rights protection (TRIPS), and trade in services. Services, which cover a wide range of economic activities such as banking, transportation and telecommunications, are an important component of the economy and of trade. While the details of the WTO's General Agreement on Trade in Services (GATS) are complex, the Agreement substantially broadened the economic activities subject to multilateral rules.

Dispute settlement is another important aspect of trade liberalization. Without an effective dispute settlement mechanism, trade liberalization measures become less secure and predictable for participants in the trading system. Yet the dispute settlement mechanism, while significantly different in nature from a tariff, also influences a firm's production

---

[6] The General Agreement on Tariffs and Trade opened for signature on October 30, 1947. The GATT, containing tariff concessions and a set of rules preventing certain trade restrictions, was signed by 23 countries. On January 1, 1948, the Agreement was implemented. There were eight rounds of negotiations in the GATT. The seventh round, which began in 1973, is referred to as the Tokyo Round, and the eighth round, which lasted form 1986 to 1994, is called the Uruguay Round. J.H. Jackson, *The World Trading System* (Cambridge, Mass.: MIT Press, 1991) provides an insightful overview of the rights and obligations set out in the GATT. The World Trade Organization, which subsumed the GATT, was established by the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations. It was implemented on January 1, 1995. The WTO currently has over 130 members. For a history of the Uruguay Round negotiations leading up to the establishment of the WTO, see John Croome, *Reshaping the World Trading System: A History of the Uruguay Round* (Geneva: World Trade Organization, 1995).

decisions and how it approaches international trade. In considering the benefits of trade liberalization, capturing the benefits of dispute settlement and rules for such practices as anti-dumping measures is extremely difficult. The literature generally recognizes that a predictable and transparent global marketplace with an effective dispute settlement mechanism is beneficial to importers, exporters and consumers.

Multilateral discipline through rules and dispute settlement procedures is particularly important for smaller economies that do not have the economic power to resolve conflicts through bilateral means. This is a useful perspective, as some consider the multilateral trading system to be in the interest of the largest economies only. On the contrary, while the system is of interest to all economies, the smaller economies stand to lose the most from its deterioration.

Trade liberalization is also intricately tied to the "new" trade agenda dealing with a range of trade-related issues. There is no consensus as to what the scope of these issues is or should be.[7] As a practical matter, the WTO has not turned a blind eye to the "new" trade issues. While the WTO does not at present have a mandate to negotiate such issues, its members see a need to more fully understand the relationships between trade and other policy areas. Soon after its creation in 1995, the WTO formally established a Committee on Trade and the Environment; at its Singapore Ministerial Conference in 1996, the WTO agreed to create working groups on the relationship between trade and investment, and trade and competition policy linkages.[8]

---

[7] U.S. Trade Representative (USTR) Charlene Barshefsky has highlighted competition law and restrictive business practices as barriers to trade. The USTR observed that with respect to Japan, "markets remain largely closed, opaque and driven more by informal cliques than by laws, rules and contracts." She also raised the issue of bribery and corruption and called for the WTO to "begin tackling head-on bribery and corruption." "Barshefsky Calls on WTO to Reduce Structural Barriers to Trade," *Inside U.S. Trade*, 16, no. 15 (April 17, 1998), 15.

[8] An earlier GATT group, the GATT Group on Environmental Measures and International Trade, had been active since 1991.

Trade and Policy Coherence

While liberalization of trade is an important component in improving living standards, it is only a component; a coherent set of policies is required to achieve a durable improvement in living standards. This is an important conclusion as it stresses that the overall balance of costs and benefits of liberalization depends upon choices made in other policy areas.

Trade and other international economic activities are linked with a complex mix of "domestic" economic, and even social, policies such as those addressing human resource development, economic infrastructure, environmental stewardship, adjustment to technology, and promotion of innovation.[9] Whether economies can seize, and benefit from, the opportunities afforded by trade liberalization in large part depends upon domestic policy decisions and how firms respond to these decisions. At the same time, the intersection of international trade with traditionally domestic policy areas raises increasingly sensitive questions of "policy coherence." This is particularly relevant and of broad public interest in respect to issues surrounding structural adjustment, such as labour market policies. Public interest is also high in regard to the linkages between trade liberalization and the environment.

Trade liberalization, by opening markets to increased competition and accentuating the ongoing structural adjustment process, makes the costs and benefits of domestic policy

---

[9] The nature of these links is not always clear or obvious. For example, bribery and corrupt business practices that distort competition and trade and investment are an issue. In an attempt to address corruption, in November 1997, OECD members adopted the Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions. For an overview of the causes and consequences of corruption, see Kimberly Ann Elliot, ed., *Corruption and the Global Economy* (Washington, D.C.: Institute for International Economics, 1997).

choices more transparent. Poor policy choices, however, with or without trade, have a cost. Turner emphasized this point with respect to Europe, by observing that Europe's unemployment problem is not due to a failure of competitiveness in the face of a global challenge, but due to a failure of economic flexibility in the face of developments most of which would have occurred even if trade and capital flows were no more global than in the 1960s.[10]

Trade and Adjustment

Trade and trade liberalization by definition imply that the composition of production and employment changes in the countries involved. This, however, in no way implies that trade is the singular or most important factor contributing to pressure for labour force adjustment. Labour markets are in constant flux. At any given time, different sectors of the economy are growing or contracting at different rates. Nor should it be understood that changes in the labour force or pressure for change, from whatever source, are an adverse economic development. In a dynamic economy, social stability must be built around the process of "creative destruction."

The economic benefits stemming from trade liberalization require adjustment, including labour market adjustment. The OECD has summarized the empirical results of a number of studies conducted on the employment effects of trade liberalization.[11] It concluded that the net impact of trade liberalization on employment is in general small at the aggregate level of the overall economy. The labour adjustment required is also likely to be small with respect to changes occurring for other reasons, such as technological change or the

---

[10] Adair Turner, "Globalization: Threat or Opportunity," speech delivered at the European Business School, March 25, 1998.

[11] OECD, *Trade and Employment*, C(89)42 (1989).

emergence of new products. The OECD report concluded that "the number of additional workers who would have to change jobs as a result of trade liberalization would be likely to be only a fraction of the normal rate of labour turnover, particularly if the trade liberalization were spread over a number of years."[12] The central conclusion of the OECD work – that the role of liberalization in labour market performance is much smaller than many believe – has also been reached by others.[13]

Employment effects on specific sectors or firms could, of course, be more pronounced. The OECD also noted that social "problems may arise if the job displacements tend to concentrate on groups of the labour force who are disadvantaged anyway, e.g., unskilled labour."[14] From a political perspective, highly visible and concentrated sectoral job losses may not offset the more diffused job gains.

Trade liberalization implies that short-term structural adjustment is necessary for longer-term prosperity. This creates challenges for other policy areas, and raises the question of how governments can most effectively intervene to facilitate adjustment by firms and individuals to new conditions caused by change, including trade. It also raises the question of whether those experiencing pressure to adjust from foreign sources should be treated any differently from those facing pressure from domestic sources.

Analysts have noted that the type of trade and the type of structural adjustment pressures that occur can influence the

---

[12] OECD, *Trade and Employment*, C(89)42, Annex Summary Report (1989), 4.

[13] Lustig puts the concern and misperception of the role of trade into stark policy terms: "identifying ways to address the rising economic polarization and declining living standards for the less-skilled in the United States deserves greater attention on the part of policy makers. Otherwise, many lawmakers are likely to continue focusing on the wrong instrument – that is, trade protection – to combat it." Nora C. Lustig, "NAFTA: Setting the Record Straight," *The World Economy*, 20, no. 5 (August 1997), 606.

[14] OECD, *Trade and Employment*, C(89)42 (1989), 29.

public's perception of whether or not trade liberalization is beneficial.[15] Trade amongst OECD countries can be characterized as intra-industry (i.e. trade in similar products). Adjustment in this case involves shifting employment and other factors of production within a firm to new production lines, or shifts within an industry. There is no major de-industrialization of a sector, and the foreign competitors are not often regarded by the public as low-cost competitors with major differences in factor endowments.

Inter-industry trade, the trade of different products from different industries in different countries, is often associated with OECD member country trade with developing countries. This type of trade can require that adjustment be made by an entire industry. The entire workforce of an industry could face change due to new, low-cost producers. This type of industry adjustment, which is much more visible to the media, prompts demands from the industry and employees to remove the threat from foreign producers (i.e. demands for protection).

Nevertheless, protectionism is not a viable, long-term strategy for improving living standards.[16] Attempting to maintain a status quo industrial structure in the face of global change is a short-sighted strategy. High tariffs and levels of protection insulate domestic producers from competition; however, over time, as international competitors increase productivity, the gap between domestic and foreign producers grows, as does the gap in living standards between the economies. Also, the longer protection lasts, the more difficult it becomes politically to liberalize, as the adjustment shock to domestic producers will be greater. Moreover, even though adjustment is a "cost" in the short run, it is a "benefit" in the

---

[15] Niels Thygesen, Yutaka Kosai, and Robert Z. Lawrence, *Globalization and Trilateral Labor Markets: Evidence and Implications, A Report to the Trilateral Commission*, 49 (December 1996).

[16] The OECD compiled a significant body of evidence on the cost of protection in a 1985 study entitled *Costs and Benefits of Protection*.

longer run. The final word goes to Lustig, who summarizes this view as follows:

> It may be important to note that even if trade protection may bring small, short-term relief for unskilled workers, this will be at the expense of lower growth and living standards – including those of less-skilled workers – in the future. A more fruitful alternative would be to pursue policies designed to upgrade the education and skills of the working population.[17]

Trade and the Environment[18]

The public has expressed some concern that, through adverse effects on the environment (in terms of increasing pollution, accelerating resource depletion and contributing to the erosion of the environmental legacy), trade lowers the overall quality of life for both present and future generations.

Some of the trade-environment interactions are direct, such as the import and export of environmentally friendly or hazardous products. Others are indirect, such as the positive influence of trade on per capita incomes, which in turn stimulates demand for a cleaner environment, or the positive impact of trade on the level of economic activity, which in turn creates pollution.

When assessing the impact of trade on the environment, the stringency of environmental policy must also be considered.[19]

---

[17] Nora C. Lustig, "NAFTA: Setting the Record Straight," *The World Economy*, 20, no. 5 (Aug. 1997), 610.

[18] The material in this section is developed substantially in Robert T. Stranks, "Trade and Environment: Post-Seattle Looking Forward," in the present volume.

[19] Analytical work by the WTO has concluded, "it is generally accepted that in order for these benefits to be realized, and for trade-induced growth to be sustainable, appropriate environmental policies determined at the national

Trade and investment are not necessarily adverse for the environment. When environmental policies are set appropriately, available evidence suggests that trade and investment usually will have a positive impact on the environment. When environmental policies are not set appropriately, trade and investment can aggravate environmental problems. A significant factor is the nature of the environmental policy itself.[20]

If prices for products are distorted, such as through subsidies, trade and trade liberalization may have an adverse environmental impact. This, however, does not imply that trade or trade liberalization should be avoided, nor that trade measures are the most appropriate response to subsidization of resource use.[21] Rather, appropriate domestic policies are required to avoid negative environmental impacts. In particular, subsidies to producers or consumers of energy and agricultural

---

level need to be put in place." This arises as the most significant trade liberalization-environmental linkages pass indirectly through effects on levels and patterns of production and consumption. WTO Committee on Trade and Environment, *Environmental Benefits of Removing Trade Restrictions and Distortions*, Note by the Secretariat, WT/CTE/W/97 (November 1997).

[20] See John Beghin and Michel Potier, "Effects of Trade Liberalisation on the Environment in the Manufacturing Sector," *The World Economy*, 20, no. 4 (July 1997), 437. They conclude: "A major policy implication that emerges from the study is the need for coordination of environmental policies and trade liberalisation reforms. Although free trade can be beneficial to the environment in the case of formerly protected and inefficient (pollution-intensive) industries, it is difficult to determine a priori the environmental implication of the post-liberalisation division of labour in manufacturing activities. Economic theory alone cannot predict trade and production patterns in dirty activities in a world of many countries, commodities, and factors of production. Hence, the presence of environmental policies is instrumental in protecting the environment."

[21] For a discussion on some of the difficulties of using countervailing duties in response to "environmental subsidies," see Robert T. Stranks, *Pandora's Box?: Countervailing Duties and the Environment* (Ottawa: Department of Foreign Affairs and International Trade, October 1994).

products often contribute to trade distortions as well as having negative environmental implications.

Moreover, trade and investment in environmentally preferred products and services are important mechanisms through which liberalization can benefit the environment. The key to this relationship is technology, and what products embodying the latest technologies, and services providing technologies, imply for the environment. International diffusion of technology and the use of efficient (resource-saving) products can be facilitated by freer trade and liberal investment policies.[22] Technology and innovation issues also imply that the links between trade and the environment need to be considered in a long-run framework.

It is worth noting that trade and trade liberalization may be characterized as being one of four things in respect to the environment: (1) absolutely beneficial for the environment; (2) neutral in respect to the environment; (3) negative for the environment, but less negative than the same level of economic growth or developments that would occur over time in the absence of trade or trade liberalization; and (4) more environmentally negative than the same level of economic growth or developments that would occur over time in the absence of trade or trade liberalization. While (1) is clearly the preferred outcome, (1), (2) or (3) should be acceptable from an environmental as well as a trade perspective.

Liberalization, Governance and National Sovereignty

Trade liberalization, and in particular that aspect of it which involves rules setting out rights and obligations, has evoked fears on the part of a number of individuals and organizations

---

[22] John Beghin and Michel Potier, "Effects of Trade Liberalisation on the Environment in the Manufacturing Sector," *The World Economy*, 20, no. 4 (July 1997), 437.

that national policy autonomy, or even sovereignty, is being gradually undermined to the detriment of society. The OECD describes this concern as "the perception that increased global competition, underpinned by global trade and investment agreements, is eroding the capacity of governments to exercise national 'regulatory' sovereignty; that is, to independently determine national policy objectives and implement regulatory decisions on both economic and social issues."[23] Yet constraints on independent action, with no regard to international repercussions, should not be considered as an inevitably negative development.

Constraints on governments may be positive, as they add predictability to the conduct of international relations and allow for a worldwide trade regime to function.[24] In other words, the WTO is not a cost to be endured. Rather, it is a benefit to be actively supported.[25] For smaller economies that would otherwise be subjected to discriminatory trade policy actions from larger economies, this is particularly important. International commitments may also act as a counterweight to protectionist forces and short-term political opportunism.[26] To the extent that there is a dilution of unrestrained sovereignty, it

---

[23] Organization for Economic Co-operation and Development, *Open Markets Matter: The Benefits of Trade and Investment Liberalization* (Paris: OECD, 1998), 76.

[24] This is not specific to trade liberalization. An important aspect of sustainable development and protection of the global commons is the recognition of the need for joint and co-operative measures that may restrain national action.

[25] It should also be recalled that the WTO is not a supranational organization, and that it only administers what its members have agreed to.

[26] This benefit is sometimes called the "Ulysses effect," where international rights and obligations help prevent governments from being tempted to favour interest groups at the expense of the economy as a whole. Kym Anderson, "50 Years: Looking Back, Looking Forward," paper presented at the Graduate Institute of International Studies and World Trade Organization, Geneva, April 30, 1998.

can be offset through the use of influence by national governments in international organizations and the establishment of international rules.[27] Globalization, and the international governance that has accompanied it, should not be seen as the death of the nation-state nor as the reckless throwing open of vulnerable domestic economies to chaotic forces.

Trade liberalization and trade governance are manifested in internationally negotiated rights and obligations. Governance is about giving direction, but it is also about providing an analytical framework for issue formulation. In an international context, with the recognition that new policy tools and international co-operation will be required, former WTO Director-General Renato Ruggiero has characterized this governance challenge as the risks and benefits of "inventing the future."[28]

Does trade liberalization, or globalization more generally, require a dismantling of national social welfare mechanisms and a race toward minimal government? The answer to this is: "not likely." The fear that governments are being rendered unable to implement regulatory decisions on social issues is not supported by the evidence. Krugman and Lawrence have emphasized that governments retain substantial autonomy in regulating their economies, designing their social policies, and maintaining institutions that differ from those of their trading partners.[29]

With liberalization in the broad self-interest of economies, and not detrimental to the exercise of national sovereignty, why is it that countries maintain and at times strengthen restrictions?

---

[27] This said, multilateral rules need to be clear and minimize uncertainty in the provisions of the agreement. This is fundamental to ensuring that a party to an agreement fully understands the rights and obligations of an agreement before signing on to it.

[28] Renato Ruggiero, "Charting the Trade Routes of the Future: Towards a Borderless Economy," speech given at the International Industrial Conference, San Francisco, September 29, 1997.

[29] Paul Krugman and Robert Lawrence, "Trade, Jobs, and Wages," *The World Economy,* 21, no. 4 (April 1994).

There appear to be two explanations. First, understanding trade and the links with the domestic economy is not an easy or straightforward task. Consequently, the public may be misinformed, and this is likely to translate into less political support for liberalization than would otherwise be the case. Second, there is a political economy explanation for protectionism.[30]

This literature draws attention to the fact that some firms and individuals gain, sometimes quite considerably, from protected markets. Protection influences the distribution of income, with the income gains being concentrated in the few who actively support political regimes that are willing to allow the protection to continue or even increase. The losses are spread over a large section of the public, and on a per capita basis are often not large enough to stimulate collective and co-ordinated action to act as a political counterweight to those seeking protection.

Based on the foregoing, the following six challenges are particularly relevant for the future of the World Trade Organization.

1. The first challenge is to preserve what has already been achieved during the 50-year period since the establishment of the GATT. In this regard, the WTO dispute settlement system has proved to be a powerful instrument for resolving complaints, either through bilateral consultations or through the panel process when consultations fail. Of particular note is that the developing countries are increasingly taking an active role, as witnessed by the fact that, in the last two years, about half of the WTO requests for consultations or panels have come from developing countries. However,

---

[30] See Gene Grossman and Elhanan Helpman, "Protection for Sale," *American Economic Review*, 84, no. 4 (September 1994); Arye L. Hillman, *The Political Economy of Protection* (New York: Harwood Academic, 1989); and Bernard Hoekman and Michel M. Kostecki, *The Political Economy of the World Trading System: From GATT to WTO* (London and New York: Oxford University Press, 1995).

contrary to some complacent views, the stability of the multilateral trading system cannot be taken for granted; government resources are required on an ongoing basis to preserve the trading system – which is a separate issue from reforming it.

2. The second governance challenge is to bring new members fully into the multilateral system. When the GATT came into effect in 1948, it had 23 contracting parties, mostly industrialized countries. This was far from a global organization. During the next 50 years, a large numbers of countries have acceded to the GATT and in turn become members of the WTO. Currently, the WTO has more than 130 members, and about 30 countries, including China and Russia, are negotiating accession.
3. The third challenge is the "built-in" agenda embodied in the Agreement Establishing the World Trade Organization, which established starting dates for further negotiations, most importantly in respect of agriculture and services. Added to the substantive negotiating issues of this built-in agenda, and the challenge of establishing negotiating modalities to most effectively promote trade liberalization and to obtain early results, is the larger consideration of bringing into multilateral negotiations a balanced set of issues outside the scope of the built-in agenda.
4. The fourth challenge is to ensure that regionalism supports multilateralism. A large number of economies are party to regional economic frameworks, many of which involve preferential trade arrangements that are inherently discriminatory and can result in trade and investment diversion. Regional arrangements are not necessarily in conflict with a multilateral approach to trade liberalization. Such arrangements may be more feasible and offer an avenue for liberalization in areas that would prove extremely difficult in a multilateral context. Moreover, regional deals can also prepare the ground for subsequent liberalization in broader multilateral agreements.

5. Many public policy issues are increasingly recognized as having both domestic and foreign components. This reflects both increased interdependence of economies and pressure to use international trade rules to achieve objectives other than those that traditionally fall under the trade umbrella. These objectives can include linking topics such as labour standards, environment, human rights or even geopolitics (e.g. Helms-Burton). These issues raise new challenges for the multilateral trading system. The efficiency implications of using trade measures in particular needs to be considered. In this respect, governance of "new" trade issues will require a high degree of coherence, co-operation and co-ordination amongst international institutions.
6. Domestic capacity building and public awareness of governance opportunities and challenges is an essential foundation for unilateral and/or collective policy action. Underlying each of the governance challenges identified in this paper is the requirement of national governments to provide leadership and seek informed public support for an open rules-based trading system. Such support rests on the public having a realistic appreciation of the benefits of trade and investment liberalization, as well as the structural changes that such liberalization will encourage or necessitate. To develop such an appreciation, individual members of the public most also think about liberalization and its effects in both the short term and long term.

Conclusions

This paper has argued for a balanced overall view of trade liberalization. Liberalization is not the root cause of the world's economic ills, nor is it the panacea. Three key interrelated themes are worthy of highlighting. First and foremost, on balance, trade liberalization is, in the long term, beneficial to society. Liberalization promotes efficiency, encourages

innovation, raises incomes and gives consumers a greater choice of goods. Liberalization is a means to an end, rather than an end in itself.

A second major theme is that while liberalization of trade is an important component in improving living standards, it does not stand alone: a coherent set of policies in other areas is required to achieve a durable improvement in living standards. This is important, as it stresses that the costs and benefits of liberalization depend upon choices made in other policy areas. This factor is particularly relevant with respect to issues surrounding structural adjustment, such as labour market policies and sustainable development.

Third, short-term structural adjustment is necessary for longer-term prosperity. This fact creates challenges for other policy areas. Most importantly, there is a need to facilitate adjustment, and for the gains from liberalization to be as widely shared as possible. This requires policies to help, in particular, those most affected by adjustment.

The concerns about trade liberalization inducing social disintegration are not justified. There is no evidence to suggest that liberalization is the main cause of income inequality. Rather, skill-biased technological change has increased demand for more-skilled workers and reduced demand for unskilled labour. Moreover, in the longer term, trade protection does not upgrade the skills of workers or contribute to a more flexible workforce, and this has its own negative social consequences. The appropriate policy response is to facilitate the adjustment of workers in increasingly knowledge-based economies, whatever the sources of change.

Addressing Trade-Related Development Needs: Options for the Donor Community

Kerry David Max
Canadian International Development Agency

This paper has benefited from the efforts of many people within CIDA and DFAIT. Special thanks are due to Dan Ciuriak, John Curtis, Fauzya Moore and the PRI-GCON World Trade Issues Working Group, as well as CIDA's Economic Development and Poverty Reduction team: Bill Singleton, Nizar Assanie, Angela Keller-Herzog, Robert Lavigne and Mariette Maillet; Nizar Assanie deserves a second mention for his heroic efforts in pulling together the final version of this paper for publication. The opinions expressed in this paper are those of the author and do not necessarily reflect the views of CIDA or DFAIT.

Summary and Overview

The failure of the WTO Seattle Ministerial to launch a new broad-based round of trade negotiations focussed international attention on the role of trade liberalization in development, and the benefits and costs to developing countries of participation in the global trading system. Developing countries will be increasingly marginalized if they cannot attract foreign investment, do not have access to technology, and cannot take advantage of a rules-based multilateral trading system. At the same time, increased integration into the world economy means

new challenges in terms of institutional, infrastructural and human resource development.

These considerations have led Canada and other donors of development assistance to question the role that they should play in addressing trade-related needs of developing countries so that opportunities from trade and trade liberalization foster economic growth, leading to poverty reduction.

This paper looks at the linkages between trade liberalization, economic development and poverty reduction; discusses some of the constraints that affect the linkages between trade and economic growth on the one hand and economic growth and poverty reduction on the other; and draws some conclusions concerning the specific role that both donors of official development assistance and trade organizations can play in addressing these linkages.

The paper highlights three categories of assistance needed by developing countries in order for them to take advantage of trade-led economic growth. The first is specific to World Trade Organization (WTO) membership and refers to the technical and legal implementation capacity required by developing countries to address their WTO rights and obligations. The second category is private sector development, referring to the presence and ability of domestic private sectors to take advantage of opportunities from trade. The third category is that of an enabling environment in the form of appropriate governance, infrastructure and policies, which are essential to the efforts of domestic and international firms to translate opportunities from trade into economic activities.

These last two categories overlap with those needed for economic growth-led poverty reduction. Here, *private sector development* refers to economic practices that provide employment and income generation for the poor, while *enabling environment* focusses on governance, infrastructure and policies needed to support the ability of poor people to take advantage of economic opportunities and provide for their needs. Finally, targeted poverty interventions may be necessary to address the

limitations of exclusive reliance on economic growth, and provide for the basic needs of those marginalized from economic activity and those unable to meet their needs based on current economic participation.

In considering how best to address these development needs, the paper recommends that the WTO, with substantially enhanced resources, concentrate on the delivery of membership-specific assistance, while private sector development, enabling environment and targeted poverty interventions fall to the donor community to address as part of overall poverty reduction programming. Co-ordination of the trade-related technical assistance activities of the WTO, its partners and development agencies could be modelled along the lines of the Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries. Alternatively, co-ordination could be mandated to an independent organization.

Trade Liberalization, Economic Growth and Poverty Reduction

This paper asks the following question: What role should Canada and other donors of official development assistance play in addressing the trade-related needs of developing countries, so that opportunities from trade and trade liberalization can be used to foster economic growth that leads to poverty reduction? We answer this question by looking at the linkages between trade liberalization, economic development and poverty reduction, and at the specific role that donors and trade organizations can play in addressing these linkages.

The assumptions that guide this investigation are as follows:

1. Trade liberalization can foster economic growth.
2. Economic growth is essential for poverty reduction.
3. Economic growth, though essential, is insufficient for poverty reduction.

4. Poverty reduction is the mandate of CIDA and the majority of development organizations.

For poverty to diminish, trade must lead, in some form or another, to an increase in the resources available to the poor for the satisfaction of their basic needs. There are three mechanisms by which trade-led economic growth could lead to poverty reduction in developing countries: increased income and employment, improved provision of government services, and decreased cost of goods and services.

Increased Income and Employment

The main expected gain from trade is stronger economic growth, leading to employment and/or wage increases. This gain occurs through a variety of mechanisms, including an increase in private sector investment, productivity gains from technology transfer and skills training, and competition-induced domestic restructuring.

In concrete terms, economic growth means more jobs for workers who produce goods and services, or higher incomes (through wage increases), or both. These impacts are felt beyond the specific businesses engaged in trade, as they stimulate both upstream and downstream production linkages.

The competition and productivity gains associated with trade may have similar effects on employment and income generation in domestic (non-exporting) industries. These can arise, for example, as new imports stimulate technology transfer, provide more efficient and/or lower-cost intermediate inputs, provide lower-cost inputs into production, etc. Similarly, competition with foreign producers is expected to lead to more efficient domestic investment choices and business practices.[1]

[1] Competition is, however, a two-way street, with some domestic firms forced out of the market, while others survive. The net effect on employment and income generation is unclear here.

Improved Provision of Government Services

Stronger economic growth should lead to increased government revenue through direct and indirect taxes, licensing fees, etc.[2] Some of this government revenue may be reinvested generally in the domestic economy and further increase employment opportunities. Other revenue, however, can be used to invest in new or existing targeted social spending and basic infrastructure of specific interest to key groups. Insofar as these investments lower the costs or increase the quality of the goods and services available to these groups, the overall cost of living will decline.

A further increase in public revenue and poverty spending may occur as a result of improvements in the effectiveness of governance brought about by trade liberalization. Indeed, the World Bank has identified trade openness as one of the characteristics leading to greater aid effectiveness.[3] As trade liberalization contributes to increasing government revenue, and to the ability of governments to better use this revenue, benefits to the poor can be anticipated.

Decreased Cost of Goods and Services

Liberalization can lead to the availability of new, lower-cost consumer imports, which may replace more expensive products

---

[2] Here, too, we must be careful to factor in losses in government revenue through tariff reductions linked to liberalization (see, for example, L. Ebrill, J. Strotsky and R. Gropp, *Revenue Implications of Trade Liberalization,* International Monetary Fund, Provisional Agenda Item 4 of Commonwealth Secretariat Global Conference on the Development Agenda for Small States, February 2000).

[3] See *Assessing Aid – What Works, What Doesn't, and Why,* World Bank Policy Research Report, Oxford University Press, 1998.

previously consumed. Similarly, cost reductions in domestic production through lower-cost inputs and competition-induced productivity gains can reduce the cost of domestically produced and consumed goods and services. Taken together, these can reduce the overall cost of consumption for poor people who consume the affected products. Likewise, even though costs may not fall, improvements in the quality of goods and services also contribute to this process.

In summary, we anticipate that trade will stimulate economic growth through a variety of positive, efficiency-promoting impacts upon domestic industries and the economy as a whole. This growth can result in increased employment and income-generating opportunities, more revenue for government spending on services and infrastructure, and a decrease in the price of goods and services. Insofar as the benefits are directed to the poor, there is little need to question the value of trade-related development assistance.

However, some researchers have found evidence that in some countries, at least in the short to medium term, poverty has not been reduced by trade liberalization and economic openness. For example, in their December 1999 paper, *The Simultaneous Evolution of Growth and Inequality,* World Bank researchers Mattias Lundberg and Lyn Squire find that in 38 countries, from 1965 to 1992, greater openness to trade is correlated negatively with both relative and absolute income growth among the poorest 40 percent of the population, but strongly and positively with income growth among remaining groups. The authors caution that "The adverse short-term consequences of openness to the welfare of the poor, and their vulnerability to terms-of-trade changes, compel us to pay greater attention to the disaggregated distributional consequences of policies in general and globalization in particular."

Constraints to Gains from Trade Liberalization and Poverty Reduction

These mixed impacts of trade liberalization on poverty reduction provide two challenges for trade-related development assistance. First, while trade liberalization and an enabling policy environment are important, there are circumstances where these are insufficient to foster stronger economic growth. Ensuring that trade liberalization actually does lead to stronger growth provides the first challenge for trade-related development assistance. Second, while economic growth in general is necessary to reduce poverty, there are circumstances where the poor may not be significant beneficiaries or may in fact be adversely affected. Making sure that trade-led economic growth does, in fact, lead to poverty reduction is the second challenge for trade-related development assistance.

Trade liberalization is ongoing in many developing countries. While some of these countries have prospered using trade as an engine of economic growth and poverty reduction, others have failed to secure the benefits described above. We explore below some of the reasons why trade liberalization has not led to poverty reduction, in order to identify constraints that may be addressed through trade-related development assistance.

A 1998 World Bank study lists the following conditions for using trade as an engine of economic growth:[4]

1. a sound macroeconomic environment;
2. an enterprise development plan to foster a dynamic private sector;

---

[4] J. Michael Finger, Francis Ng and Isidro Soloagra, "Trade Policies in the Caribbean Countries: A Look at the Positive Agenda," World Bank paper prepared for Caribbean Group for Cooperation on Economic Development, Washington, D.C., June 1998, 10-11.

3. a corresponding human resource development program in both the public and private sector;
4. a trade facilitation program, including customs administration;
5. physical (transport, communication, electricity) and legal-institutional infrastructure; and
6. effective use of the WTO and other international instruments.

While it is clearly unnecessary to meet all of these conditions in order to gain from trade, many developing countries, especially those among the least developed, cannot meet any of them.[5] Similarly, many developing countries lack other characteristics related to productive capacity, including the availability of a sufficiently skilled labour force, enabling regulatory frameworks, modern financial sectors, etc. In the absence of these characteristics, trade openness alone may not lead to economic growth.

Even where these characteristics do exist at the national level, and trade does lead to economic growth (as it does in the vast majority of trading nations), the poor may not be beneficiaries of this process. In other words, there is nothing implicit in the structure of trade or trade liberalization that ensures that the positive impacts described above will be experienced by the poor, as opposed to the non-poor.[6]

---

[5] In some cases developing countries *will not* develop these conditions, due to lack of political will and commitment to reforms. However, while these circumstances require different approaches to addressing the absence of these conditions, the fact remains that they continue to be a significant barrier to effective gains from trade.

[6] It is true that in many developing countries, the primary resource is an abundant supply of relatively low-cost labour. Insofar as trade in these countries results in economic growth in sectors or industries that absorb this labour pool, there will clearly be an impact on poverty, although even there the net effect may be reduced due to rural to urban migration, dislocation of non-competitive industries, poor labour and environmental standards, etc.

In a USAID working paper, the authors point out that the extent to which trade leads to poverty reduction depends to a large degree on where the poor live and the orientation of the government's strategy for the provision of social services and infrastructure.[7]

For example, since most industry-oriented trade-led economic growth takes place in urban centres, only poor people located in these centres are likely to benefit in a significant way. In Latin America, Eastern Europe and parts of Asia (excluding India and China) many, if not most, of the poor are located in urban areas, so their gains may be significant. However, in other parts of Asia, and in most of Africa, the majority of the poor live in rural areas. Indeed, on a global scale, it remains true that the majority of the poor are rural, not urban. While this group of people stands to gain considerably from liberalization in agriculture (which is proceeding at a much slower pace than liberalization in non-agricultural goods and services), insofar as the focus of trade-led investment remains primarily urban, many or most poor people may fail to benefit from the direct employment and income effects of trade-led economic growth.

Indirect benefits from government services and cost of consumption reductions may also be limited for the poor. Although some government programs explicitly target rural and marginal areas, in many cases government infrastructure and social spending, for obvious political reasons, is disproportionately oriented toward urban centres and non-poor neighbourhoods therein, once again missing the bulk of the poor population in many countries. Similarly, because the rural poor tend to consume more non-tradable domestic goods and services (products that are only domestically produced) relative to their

---

[7] *Trade, Economic Growth and Poverty Reduction,* U.S. Agency for International Development, Discussion Paper No. 1, 2000.

urban counterparts, they are less likely to gain from falling consumer prices.[8]

There are a variety of other issues raised by civil society groups concerned with the negative impacts of trade liberalization on vulnerable people and countries that, in combination with the warnings above, illustrate the costs and potential limits to the benefits of trade-led economic growth.[9] None of this is to deny that trade leads to benefits for large numbers of people; indeed, most studies have found positive correlations between trade openness and increases in per capita income growth.[10] Rather, we need to caution against taking the poverty-reducing outcome from trade as a given.

Trade-Related Development Needs

The evidence showing that trade liberalization can result in a more unequal distribution of income is an indication that the benefits of trade in many countries are disproportionately captured by the non-poor. However, less equitable income

---

[8] The urban poor, whose consumption of tradable goods is higher than that of their rural counterparts (although still lower than that of the non-poor), may benefit to a larger extent.

[9] These include circumstances where trade-led growth is capital-intensive and fails to employ low-skilled workers; dislocation, through trade-induced competition, of existing workers and producers of goods and services who are unable to match their more productive international counterparts; and the exacerbation of an already unequal distribution of resources, due to which the poor cannot access the skills, land or finances that would enable them to take advantage of trade-related opportunities. There are also concerns about exploitative environmental and labour practices in the absence of enforced national standards, leading to short-run gains and long-run losses for individuals and society as a whole.

[10] See, for example, the March 2000 World Bank paper, *Growth* Is *Good for the Poor,* by David Dollar and Aart Kraay.

distribution may not be considered a problem in and of itself if overall poverty is declining (i.e. if incomes of poor people are growing, but at a slower pace than those of the non-poor). Nevertheless, as previously mentioned, some researchers have found that openness to international markets has reduced the income of the poor in some countries.[11]

These observations lead us to the question of what the international community can do to ensure that (1) trade liberalization does indeed lead to economic growth; and (2) trade-led economic growth leads to poverty reduction. We highlight two categories of support that may be required.

Trade Liberalization-Led Economic Growth

The first category of support corresponds to the ability of countries to use WTO membership, and their private and public sectors, as mechanisms that enable trade and trade liberalization to contribute to economic growth.

Trade and WTO membership: Many developing countries lack the technical, legal and administrative capacity to exercise their WTO membership rights or to fulfil their WTO obligations. Assistance in this area would enable developing-country members to better use WTO disciplines to their advantage in securing gains from international trade. Specific needs include:

- improved understanding of WTO rights and obligations;

---

[11] In addition to the report by World Bank researchers Lundberg and Squire, noted earlier, see Barbara Stallings and Wilson Peres, *Growth, Employment and Equity: The Impact of Economic Reforms in Latin America and the Caribbean*, UN-ECLAC, forthcoming from Brookings and ECLAC, Spring 2000.

- help in drafting and implementing legislation and regulations to comply with WTO obligations;[12] and
- technical expertise to participate in trade negotiations, WTO committee activities and trade policy reviews, as well as to use the trade dispute mechanism effectively.

Trade and private sector development: In many developing countries, the formal private sector is insufficiently developed to take advantage of the opportunities from improved market access negotiated in trade-liberalizing agreements. Furthermore, the generally much larger informal sector may be constrained from formal participation. Assistance in this area would include provision of technical and legal expertise to facilitate international market participation

Trade and enabling environment: The successful development of the private sector and its subsequent involvement in international trade depends to an important extent on a supportive public policy framework and a functional economic infrastructure. Assistance here would include support for:

- development of government capacity (including both parliamentary and bureaucratic capacity);
- essential physical economic infrastructure (roads, ports, communication systems, etc.);
- legal and financial institutional infrastructure; and
- implementation of social (e.g. labour standards), environmental and gender policies and programs that are also associated with faster and more sustainable growth.

---

[12] Given the significant financial costs of implementing the WTO, additional financial resources may also be required. This is especially true if the poorest WTO members are to avoid facing a trade-off between poverty reduction programming and WTO obligation implementation. See J. Michael Finger and Philip Schuler, *Implementation of Uruguay Round Commitments: The Development Challenge* (Washington: World Bank, October 1999).

Economic Growth-Led Poverty Reduction

A second category of trade-related development needs corresponds to factors that determine the ability of countries to use the economic growth facilitated by trade and trade liberalization in order to reduce poverty and faclitate efforts of poor people to gain access to productive assets, employment and income-generation opportunities.

Poverty and private sector development: Attention here is directed toward integration of the informal economy (where more of the poor work) into the formal economy, where better opportunities exist. Incentives for the private sector to participate in global trade in ways that are more beneficial to the poor can contribute in this regard (e.g. adopting low-skill, labour-intensive production processes).[13]

Poverty and enabling environment: The emphasis here is on adaptation of public policies, services and infrastructure, including financial services oriented to micro credit, to address the challenges of access by the poor, and especially poor women, to economic opportunities. A poverty lens also needs to be applied to social, environmental and gender equity policies and programs.

Poverty and targeted interventions: For a variety of reasons, many poor people may not be able to participate in the market economy. There may also be new groups of poor created by the structural reforms associated with trade-led economic growth. As a result, interventions are needed to specifically target the needs of both those who are marginalized within economic

---

[13] There is some controversy in this last regard, in that over the long run, development history has shown that labour-intensive processes tend to be inefficient relative to capital-intensive techniques. This implies that as the relative cost of capital declines, in part due to the process of liberalization itself, and as competitive capital-intensive goods displace low-productivity substitutes, low-skill employment generation may become ever more difficult to promote (from private correspondence with Nizar Assanie).

systems and those who cannot, even within current economic systems, meet their basic needs. Through a focus on access to productive resources, better health, education and empowerment, this area of assistance may foster the conditions for their future market engagement.

An International Division of Labour for Trade-Related Assistance

As can be seen from the above discussion, there is a great deal of overlap between needs corresponding to trade-led economic growth and those corresponding to economic-growth-led poverty reduction. This observation is significant since it is precisely by focussing on the areas of overlap that donors can best leverage scarce development resources in support of both economic growth and poverty reduction. This paper makes two recommendations for the division of trade-related assistance that would leverage the relative expertise of bilateral donors and multilateral agencies.

Recommendation 1: donor assistance: We recommend that donors of development assistance target their trade-related resources toward those activities that are known to facilitate both trade-led economic growth and economic growth-led poverty reduction.

Recommendation 2: WTO membership: We recommend that the World Trade Organization, primarily through non-aid resources derived from assessed member contributions and private sector donations, direct the provision of the technical assistance required so that all developing countries (both members and those waiting to accede) can understand and meet their obligations, and can understand and exercise their rights of membership in the WTO.

We address each of these recommendations in turn.

Donor Assistance

Donors should focus on trade-related capacity development, which is known to have benefits for the poor.[14] We agree that trade liberalization can lead to economic growth and that economic growth is an essential contributor to, although not a guarantee of, poverty reduction. We have also identified a number of constraints that impede the success of some countries attempting to use trade liberalization as an engine of economic growth, and economic growth as a tool for poverty reduction. There is thus an obvious need for assistance that addresses these constraints.

The question then becomes who should address which constraints, with the answer depending on the mandate of the providers of such assistance. As stated previously, donors of official development assistance have a poverty reduction mandate. These donors have scarce financial resources to devote to this mandate. Therefore, donor assistance should be directed toward interventions that have the greatest impact on poverty reduction.

Although membership in the WTO addresses some constraints to gains from trade, we believe that assistance for private sector development and enabling environment, from

[14] We recognize here that not all activities by donors are subject to a poverty reduction mandate. For example, within CIDA, the Central and Eastern Europe Branch does not require poverty reduction.

both a trade and a poverty reduction perspective, will have a broader impact on key constraints to economic growth and poverty reduction. This latter set of needs is thus the optimal target for trade-related development assistance.[15]

WTO Membership

In the absence of donor assistance related to WTO membership, other organizations will need to address these needs. Those best suited to providing the specific legal and technical advice needed for implementation of trade agreements and participation within the WTO are the WTO itself, and member state public and private sector organizations with experience in the global trading system. These organizations should work together, under the direction of the WTO, to provide the membership-specific technical assistance required for full participation by developing countries in the rules-based multilateral trading system.

Although the WTO, as the organization that oversees the implementation of the rules of multilateral trade, is the obvious choice for a centre of expertise to address developing-country membership needs, it is also a small organization with limited personnel and even more limited financial resources. This being the case, its trade-related technical assistance capacities need to be expanded considerably, albeit within a very narrow focus. The responsibility for providing the resources for this expansion lies with WTO member states themselves, which have previously committed themselves to providing these resources, either through the WTO proper or through their own government programs.

---

[15] By this recommendation, we are not suggesting that donors cease to address other poverty-related needs, nor that they restrict their enabling environment and private sector support to only trade-related activities.

There is little doubt that, in spite of their promises, members of the international community have not kept up with the demand for financing and technical assistance needed to address developing-country needs with respect to WTO membership. It is now their responsibility to do so, through supporting the WTO in addressing membership-related needs, and supporting donor agencies in broad development capacity building. In the event that public resources remain insufficient, the WTO should turn to private sector companies (strictly through a trust fund mechanism) that stand to gain the most from full participation in trade by developing countries, so that these companies can fund the technical assistance that their domestic governments are unable or unwilling to support.[16]

Co-ordination and Coherence

These recommendations are intended to ensure that each type of organization delivers the trade-related assistance that best conforms to its organizational mandate and expertise. However, as previously mentioned, we acknowledge that WTO membership-specific needs and enabling environment or private sector development needs are related. Indeed, we have already accepted that both are linked to economic growth, which is necessary for poverty reduction. From a development perspective, efforts aimed at addressing WTO membership needs should be consistent with an understanding of the

[16] The idea of private sector funding was first suggested by WTO Deputy Director-General Andrew Stoler. While we admit that it would be extremely difficult to set up a system acceptable to both developing countries and supporting corporations, and that there could be considerable free-rider problems, the idea deserves further exploration as long as public funds remain insufficient.

linkages between economic growth and poverty reduction.[17] Likewise, efforts to promote poverty reduction should be consistent with an understanding of membership-related needs. This being the case, both donors of development assistance and providers of WTO membership-specific assistance will greatly benefit from co-ordination and co-operation, to ensure that activities are as coherent and complementary as possible.

This requires a further level of international co-ordination. The Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries may provide a model that can be adapted to ensure that all actors in the area of trade and development work together. Alternatively, an independent organization could be granted the mandate of overseeing the trade-related technical assistance activities of the WTO, its partners and development agencies.

Further Needs and International Opportunities

As stated at the outset, the eyes and ears of the international community are focussed on trade and development. This issue was prominent at the April 2000 World Bank and International Monetary Fund spring meetings, and will remain high on the international agenda. The more general issues of globalization and its impacts are likely to remain a rallying cry for the civil society groups that massed in Seattle and Washington, D.C., and that intend to continue voicing their concerns.

While the degree of attention to these matters can make discussions difficult, it also provides an opportunity to suggest new ways of confronting challenges and to secure support for efforts that both address the needs of developing countries and

[17] This is likely to be true as well from the perspective of maintaining support for the WTO and global trade. In the absence of clear benefits to poorer countries, the potential for a backlash against multilateral trade is significant.

reinforce the strength of the multilateral trading system. Some of the questions that have been raised in this paper require further exploration, as do the recommendations.

The trade and development community needs to further address:

1. the causal relationships (both positive and negative) between trade liberalization and economic growth, on the one hand, and trade-led economic growth and poverty reduction on the other;
2. the best ways of addressing constraints that interfere with the positive causal relationships, and solutions to the problems arising from the negative causal relationships;
3. the optimal sequencing of reform implementation so as to minimize negative impacts on income distribution and poverty;
4. the actual value of WTO membership (as opposed to trade liberalization) for the smallest, economically weakest members, given the absence of financial and technical assistance in implementation of WTO obligations;
5. the value added of the individual actors in the trade and development communities in responding to identified needs; and
6. the optimal means for ensuring co-ordination and complementarity in the efforts of these trade and development organizations (internationally, nationally and within the organizations themselves) in order to achieve the ultimate objective of promoting prosperity for all.

Trade Liberalization: Culture, Identity and Social Cohesion

Bruce Jamieson
Department of Canadian Heritage

This paper was prepared on behalf of the PRI-GCON Working Group on World Trade Issues. The author is with the International Comparative Research Group, Strategic Research and Analysis Directorate, Department of Canadian Heritage. The opinions expressed in this paper are those of the author and do not necessarily reflect the views of the Department of Canadian Heritage.

Introduction

> *The challenge in this era of globalization – for countries and for individuals – is to find a healthy balance between preserving a sense of identity, home and community and doing what it takes to survive within the globalization system.* (Thomas L. Friedman, *The Lexis and the Olive Tree*, 1999: 35)

According to a recent public opinion survey, *The State of Affairs in the Nation Today* (The Goldfarb Report 1999), 73 percent of Canadians now support the North American Free Trade Agreement (NAFTA) and 65 percent support Canada's participation in trade agreements in general. Canadians think that the impact of trade agreements is beneficial to our economy, particularly because they believe it provides them with greater product selection. Moreover, a majority of citizens think that increased trade (both exports and imports) with other

countries will result in more jobs for Canadians. However, the survey also notes that many Canadians do not believe that they have a firm grasp of this issue. Trend data on the impact of the World Trade Organization (WTO) and the General Agreement on Tariffs and Trade (GATT) show that two out of five Canadians say that they do not know what the impact of the WTO or GATT will be.

Despite the growing support for freer trade, the recent, sometimes violent, public protests at meetings in Seattle and Washington demonstrate that there is growing concern that the benefits of freer trade for society as a whole may be outweighed by the costs. In addition to economic costs and benefits, trade liberalization has an impact on many other aspects of our society: the environment, population movements, health, dissemination of knowledge and expertise, national identity, political and cultural sovereignty and social cohesion.

Some critics see international trade agreements as impinging on national sovereignty and posing a threat to basic social policies and programs, social solidarity and the distinctness of national identities. There has also been a strong public reaction against the power and influence of "faceless" transnational corporations and a perception that international regulatory institutions, such as the WTO, are undemocratic. The growing realization that decisions taken in the context of international trade have wider implications for such things as culture, environmental and labour standards and human rights has pitted the interests of business against the interests of social activists and other groups, causing social conflict and placing the WTO and other international institutions in the uncomfortable position of having to arbitrate on issues outside their envisioned mandates and areas of expertise.

This paper is not intended as a treatise or as a presentation of original research, but rather as a review of a representative selection of the most recent literature reflecting a wide range of domestic and international thinking on how trade liberalization affects culture, identity and social cohesion. It will examine the major issues relating to three sets of questions:

1) What impact is trade liberalization having on Canadian culture and specifically on Canadian cultural industries?
2) How is trade liberalization affecting the legitimacy of the nation-state as a repository of distinctive, common cultural values? What impact is trade liberalization having on national identities? Is homogeneity of the world's culture one possible eventual result?
3) What are some of the short- and long-term impacts of trade liberalization on social cohesion? What role does the nation-state play in mitigating these impacts?

This review of the literature will be followed by a discussion of how trade/culture issues are being addressed by international organizations and a summary of new strategies that have been proposed to deal with these issues in Canada.

Free Trade and the Cultural Industries

American cultural influences can now be found in even the remotest corners of the world. Geographically, Canada is the least remote corner of the world in relation to the United States. Given this geographical proximity, a common language shared by the majority of their citizens, common historical roots and many common influences on legal and political traditions and economic development, it is not surprising that the influence of American popular culture on Canadian culture, particularly English-Canadian culture, is overwhelming. Maintaining a flourishing Canadian culture has been and continues to be an important challenge for individual creators, the cultural industries and policy makers. As the 1987 federal policy paper, *Vital Links: Canadian Cultural Industries*, asserts:

> The bond that holds Canadians together is our distinct culture – not just in the sense of the arts, but in the larger meaning of our pastimes, habits, images, institutions, perspectives on the world, collective memory and our bilingualism and multiculturalism. Our culture is to a large extent the expression of who we are. (1987: 77)

Vital Links concludes that Canadian culture is "active and assertive"; however, it also suggests that the instruments of communication of this culture, the cultural industries, face difficult competitive odds. How, then, in this period of global economic integration, can we ensure the development of healthy and competitive cultural industries?

> There is a vital need in Canada to ensure that the burgeoning cultural development in the creative sense be marked by the development of healthy instruments of communication. Without them, creativity could still take place, but fewer Canadians would have access to these creations. The most evident need is to help join the creator in Canada to his or her audience. The cultural industries are the conduit. (77)

Recognition of this vital need to develop and maintain healthy Canadian cultural industries was one reason for negotiating an exemption for culture in the Canada-United States Free Trade Agreement (FTA). Yet, since the coming into force of the FTA in 1989, the effectiveness of the cultural exemption has been the focus of a great deal of discussion and criticism. Is it achieving its intended purpose, enabling Canadian "cultural" industries to flourish in a market dominated by American "entertainment" industries? If it is not, is there a better strategy to address this challenge?

In an article published only two years after the signing of the FTA, "Trade Liberalization and the Political Economy of Culture: An International Perspective," Graham Carr addresses three issues that he feels are fundamental to a reformulation of the Canadian position on free trade and culture: first, by exploring the nature and extent of American government involvement in culture in relation to Canada's strategy of "exemptionalism" pursued in the FTA; second, by examining the relationship between the U.S. position on culture in the FTA negotiations and the larger context of American foreign and commercial relations; and, finally, by considering how culture is treated in various international trade agreements involving countries of disparate size, wealth and power. (1991: 3-4)

Carr notes that some misgivings about the FTA stem from discrepancies between the official Canadian and American interpretations of the agreement. While Canada stresses that the FTA protects indigenous culture by exemption, the United States maintains that this measure is protectionist and is offset by a second provision that justifies retaliatory measures. There are also several unresolved issues not addressed in the FTA, including the definition of subsidies, the Canadian review of foreign takeovers and protection of intellectual property, as well as the allowable parameters for the discussion of these issues. (1-2) Despite these ambiguities, Carr feels that one thing is clear – Canada is again being put on the defensive in the cultural sphere. Yet instead of developing fresh ideas to deflect this pressure, Canadian commentators seem inclined to restate their old positions in order to "educate" our trading partners and convince them that the onus for accommodation is on them. (2-3)

Carr believes that by becoming better educated about American cultural policies and their importance in the context of larger U.S. commercial and diplomatic interests, and by becoming more attuned to the cultural dimensions of other international trade accords, Canadians will be better able to answer some of the fundamental questions raised by the FTA about the nature of culture and its relationship to trade liberalization. (5) The goal of his paper is to propose an analytical framework out of which might emerge an adequate response to American challenges and a better ability to advance Canada's cultural interests in the future. (5)

Turning to the FTA itself, Carr notes that although cultural industries are exempted under Article 2005(1), cultural issues intrude in several other places: elimination of duties on certain cultural products (Article 401); facilitation of cross-border telecommunications and information flow (Annex 1404 C); entry restrictions for persons engaged in certain cultural activities (Annexes 1408 and 1502(1)); restriction of foreign ownership in communications and cultural industries (Articles 1607(1) and 1607(4)); strengthening intellectual property

protection (Article 2004); adjusting copyright legislation for cable transmission (Article 2006); repeal of certain sections of income tax legislation pertaining to advertising deductions in Canadian periodicals (Article 2007); dispute management mechanisms that may affect certain areas of culture (Article 2011); and which cultural industries are covered by the agreement and which are not (Article 2012). (7)

Carr concludes that "As far as Article 2005 goes, therefore, FTA is the diplomatic equivalent of squaring the circle: culture may be exempted from the agreement, but 'it most assuredly has not been left out.'" (7-8) Furthermore, he notes that critics of the agreement feel that Article 2005(1) is rendered irrelevant by Article 2005(2), which allows retaliatory measures of "equivalent commercial effect," meaning that not only could it negatively affect non-cultural sectors of the economy for "affirmative action" taken to protect culture, it might also discourage the government from supporting culture altogether. (8) He also believes that these fears are compounded by Article 2011, which outlines procedures for dealing with measures perceived by either party to be discriminatory, measures that do not apply to section 2005 but do apply to other sections of the FTA involving culture. (8)

As Carr illustrates, contrary to popular belief, the United States has a long history of government intervention in providing support for culture (funding, regulation and protective measures), and "From the vantage point of free trade, it is equally relevant to acknowledge the broad policy similarities which exist between the two countries by recognizing that 'a fully articulated system' of support for culture exists in the United States, and that government is instrumental in its success." (18) He suggests that "Canada would be better off if it reminded the United States of its own historical tradition of government aid to culture, and emphasized the genuine similarities which characterize current policies on both sides of the border." (18)

Carr also suggests that Canadians have failed to recognize the importance the United States attaches to culture as part of its

larger foreign policy agenda because the American approach to culture in international affairs is different from our own, the definition of culture being linked to the free flow of information, technology transfer, exchange of services, and protection of intellectual property and connected to the doctrine of free trade. (19) He feels that "By harping on the fact that the two countries are each other's principal trading partners and extolling the special relationship they profess to enjoy, Canadians overlook the importance of global considerations in the development and deployment of American policies regarding Canada." (19) Carr feels that the Canadian preoccupation with cultural industries and markets within the context of the FTA has obscured the possibility of seeing that American interest in the cultural provisions of the FTA transcends the relationship with Canada and is of larger importance in setting a precedent for bilateral and multilateral negotiations with other countries. (19-20)

> By establishing the principle that culture is a commodity, by associating culture exclusively with industry, by formalizing a commitment to the transnational trade in knowledge, by liberalizing trade and information in cultural services, and by initiating the process for a comprehensive undertaking on intellectual property, the United States has furthered its global cultural interests through both direct and indirect means. In the process it has also set a precedent for follow-up negotiations on culture with Canada, and laid a basis for future bilateral and multilateral agreements with other countries. (29)

In order to adequately prepare for follow-up negotiations on culture-related issues, Carr feels that Canadians must transcend their obsession with national identity and focus on the political economy of culture in the broader context of American international affairs, realizing that "the fundamental issues raised by FTA concern the nature of culture and its relationship to information, technology, services, commodities, and property." (29)

Carr believes that comparison of the FTA with other trade treaties, such as the Convention Establishing the European Free Trade Association (EFTA), the Ireland-United Kingdom Agreement Establishing a Free Trade Area, and the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), is required, not only because it reveals that the issues at stake are not unique, as might appear at first glance, but because it establishes both technical and political reference points that may prove useful in the implementation of the FTA. (30) While culture received scant treatment when these agreements were drafted, they nevertheless included measures directly related to culture such as the right to protect intellectual property and copyrights, public morals and national treasures of artistic, historical and national value, issues that have recently taken on heightened economic and political importance. (34)

Despite the vagueness and contradictions typical of many aspects of cultural policy contained within them, Carr feels that Canada can draw useful conclusions about the difficulties of assimilating culture into free trade agreements. (37)

> Above all, case histories of these agreements demonstrate that trade agreements are meant to be altered. If experience is any guide, there is little reason to expect that Article 2005(1) will be a permanent solution to Canadian cultural anxieties. Similarly, the failure of these agreements to reach anything like a comprehensive policy on culture is indicative of the extraordinarily complex nature of the challenge. (37)

Carr concludes that the debate on culture "increasingly revolves around its meaning in relation to other forms of knowledge, and the altered value of cultural production to the changing structure of the global economy." (38) Underlying these issues are ideological disputes about the benefits of state policy versus private enterprise, individual rights versus the public interest. (38) In order to effectively meet the challenges posed by free trade, Carr is convinced that "Canadians must break away from the nationalist paradigm which has

traditionally determined their thinking on culture and examine the political economy of culture in an international context." (38) In his view, the problem with focussing on preserving sovereignty alone, although it is an important issue, is that it masks the complexity of cultural questions raised by the doctrine of free trade. (38)

In 1994, the *Canadian Journal of Communication* devoted a special issue to the subject of cultural development in an open economy (volume 19, 3/4). This collection of papers was written in response to an initiative by the Social Sciences and Humanities Research Council (SSHRC) in co-operation with the federal Department of Communications (now Canadian Heritage). The papers focus mainly, though not exclusively, on the cultural industries rather than on issues related to culture in its broader sense because the authors felt that in an era of mass communications and current global economic trends cultural industries face particularly long odds. I have chosen to summarize four papers from this collection that I feel deal with cultural issues in the broader sense.

In the first paper, "Of Culture, the Economy, Cultural Production, and Cultural Producers: An Overview," Rowland Lorimer and Nancy Duxbury adopt a sense of culture that "emphasizes the distinct set of values of Canadians and their embodiment in social, cultural, and political institutions, statutes, and practices, as well as our patterns of behaviour both as audience members and producers." (1994: 260) Culture is seen as "everything that can be shared" (261), not derivative of other forces but rather a primary element in the creation of human communities. In the context of an open economy, this means that culture "fully encompasses the economy, including the perspectives on life and work the economy encourages, the patterns of life it demands, and the selectivity of its visions." (261)

Lorimer and Duxbury note strong biases operating on both sides of the discussion of cultural issues arising from Canada's open economy. A strong economic bias commonly derives from the notion that since economics is the study of scarcity, it is,

therefore, relevant at all levels and to all types of decision making in society. A cultural bias views economics as useful for understanding certain categories of behaviours but questions giving economic ideas priority over all others or extending economic ideas as foundational elements into other realms of society. (274) They also feel that, in order to better understand the different approaches to cultural industries adopted by various countries, it is important to examine the underlying philosophies guiding cultural development policies and programs. They define four basic models that have informed cultural policy in Canada and around the world:

a) the *community development/animation model* – based on belief in the value of information and self-knowledge and oriented to the idea of the community representing itself through various mediums that raise self-awareness;
b) the *cultural development model* – aimed at making accessible to the greatest number of citizens the outstanding works of humanity, ensuring the largest possible audience for national cultural heritage and favouring the creation of such works;
c) the *public service model* – aimed, more conservatively than in the cultural development model, at the preservation and promotion of national heritage (values and artifacts), especially through publicly funded institutions; and
d) the *market model* – both the current *global market model,* directed toward a free global market ever less hampered by governments, and the *cultural market model,* aimed at promoting merit goods, countering the effects of market failure or protecting infant industries by intervening in the market to apply correctives in the name of cultural development. (265-269)

In their view, the cultural development model is perhaps best exemplified by the approach taken by France; the public service model, by the United Kingdom; and the global market model, by the United States. (265-269) They see Canadian policies and programs as based on both the Canadian experience and the experiences of other countries – the United Kingdom,

the United States, France, Australia and the Scandinavian countries – and, as such, as being both derivative and original: "derivative in the sense that they take into account the actions and analysis of other countries, original in the sense that they respond to the realities of the Canadian scene." (269) Generally speaking, with the exception of broadcasting policy, Lorimer and Duxbury feel that the cultural market model best describes the approach underlying current Canadian policy and programs. They note that Canada has also drawn on the community development model, although they feel that this philosophy has faded somewhat from the mainstream research and writing about culture. (265-269)

The difference in approach taken by Canada and the United States on the treatment of cultural industries in trade agreements can, in their view, be traced to the founding principles of each nation. "On the United States side the foundations of this approach to cultural industries reach to the Constitution and the Supreme Court. (Head and Sterling, 1990, p. 464) On the Canadian side the roots are more nebulous but equally basic. They are to be found in nation-building, the public interest and cultural sovereignty." (278)

> Canada's position starts with culture, acknowledges the industrial nature of cultural production in our modern information economy, and ends with cultural goals which may be achieved in part by industrial means. The U.S. position starts with markets, speaks in the language of free trade, property rights in copyright, free speech, free flows of information, consumer rights, and entertainment products, and ends with markets. Their practice is dramatically different. Private foundations support cultural activity, employment restrictions are endemic, the courts are often used to harass competitors, and certain laws may be invoked unilaterally when politicians can be persuaded to act. (277-278)

The authors also note that, under the current trade regime, Canada's bargaining power is not substantial. The coercion that can be mounted against us to live within the American

interpretation of the GATT makes it appear as if our bilateral agreements (FTA and NAFTA) are the main source of our difficulties (275). "Given the size, power, social and political philosophy, and inclination of the United States to insist that other countries conform to its viewpoint rather than vice versa, the opening of our economy primarily to the United States, and then to the rest of the world means a lessening of our government involvement in organizing the economy, and in any activity that can be argued to be economic in consequence, particularly culture." (275-276)

In terms of socio-economic and socio-cultural implications, the authors believe, "An open economy changes the universe of choices for producers, consumers, and governments to the degree that they orient to it. In some cases it forces such changes." (276) They predict that this will result in an enhanced consumer loyalty at the local as opposed to the national level and an increased orientation to the international with the greatest diminution of regional and national loyalty in the economic sphere followed by a diminution in the social arena. (277) They suggest that product planning, design, marketing and distribution require transnational thinking, just as consumers and workers will have to reconsider their choices in a transnational context. (276)

In overview, Lorimer and Duxbury feel that the literature on Canadian cultural development philosophy, policy and programs is mostly commentary, outlining the evolving positions of the main players but containing little formal research. (272) They note that information on Canada's cultural industries is neither extensive nor thorough – nor is it being continuously generated; and that, on the whole, we are not very far along the path in gaining this information. (285) They believe that research which can inform the understandings, philosophies, policies and programs for cultural development in an open economy begins with a full understanding of culture and proceeds through:

- a conception of the relationship between culture and cultural development;

- the nature of spontaneous and deliberate cultural development;
- the historical and contemporary nature of cultural development and its philosophies, policies and programs;
- an understanding of Canadian cultural particulars and their changing nature;
- the nature of Canada's opening economy and the cultural orientation of our free trade partners as well as that of major trading blocs;
- the nature of the interaction between culture and the economy;
- the potential need for stimulation of integrative activities as well as activities that affirm the distinctive groups within Canadian society;
- the full nature of the structure and infrastructure of cultural development and cultural industries; and
- the educational preparation and sustaining mechanisms for cultural workers. (285)

In their paper, "Cultural Development and the Open Economy: A Democratic Issue and a Challenge to Public Policy," Marc Raboy, Ivan Bernier, Florian Sauvageau and Dave Atkinson begin by observing that economic globalization poses an unprecedented threat to public policy in the area of culture by upsetting the fragile balance between economics and culture. They feel that the role of the state is to redress this balance through policies that promote cultural development, essential not only to national culture and identity, but also to democratic public life. (1994: 291) They acknowledge that their view is clearly a "positioned one" and that, for some, cultural development refers only to the development of cultural industries – their concern is for the social aspects of culture. (293) "The democratic stake in cultural development is to re-establish the citizen's right to contribute to public life and, in this respect, to promote access to and participation in the cultural sphere" which, the authors maintain, "is increasingly centred in the mass media." (291)

Noting the efforts of several European countries, led by France, to exclude culture from the 1993 GATT negotiations, the authors point to the increasing focus on cultural matters as a point of friction in the developing global economy. (292) They suggest that with the liberalization of international trade, one finds "a critical shift," a displacement of the traditional logic of state intervention in the economy based on the supply of goods and services in response to social and political considerations, with a new logic based on consumer demands. (295)

While governments and cultural industry spokespersons are increasingly justifying state support for culture by arguing the need to maintain cultural sovereignty and to create a market favourable to national cultural products, the authors argue for a different approach that emphasizes the importance of cultural development. (296) Cultural development is defined as "the process by which human beings acquire the individual and collective resources necessary to participate in public life." (292) As such, cultural development provides the resources that enable citizens to intervene socially, economically and politically. (296)

The view that commodifies culture "excludes and marginalizes all cultural practices that cannot be materialized in a market relationship, with the result that, for most people cultural activity becomes a socially neutered act of consumerism – one among many. Furthermore, placing a priority on industrial concerns means that cultural participation is increasingly a function of one's capacity to pay, thus extending existing social inequalities to the cultural sphere (Murdock, 1992)." (302-303) "The role of the state in this context is to redress the balance and see that democratic imperatives are not subordinated by industrial ones." (303)

The authors support a paradigmatic shift in emphasis in public policies, from cultural production to networks of distribution and points of consumption. They feel that emphasizing the principle of accessibility would foster a more active relationship between creators and users of cultural products. (310) This perspective of democratic cultural

development would also require a broadening of the range of cultural institutions that enjoy public support, more social uses of new communications technology and a new look at media regulation as a means of ensuring equitable access to distribution markets for producers and consumers while continuing to meet public service objectives. (307)

> As we have seen, the principal justification for state intervention through cultural policy has, in most cases, focused on the need to promote national culture and national identity. Public policy should rather, in our view, seek to promote cultural development because it is essential to democratic public life. (310)

Richard Collins' paper, "Trading in Culture: The Role of Language in Cultural Development in an Open Economy," examines the impact of globalization on the ability of policy makers to achieve cultural goals. He considers why the imperatives of cultural and economic development are so often perceived as contradictory and examines the meaning of culture in the current context of globalization of economic activity. He also examines the importance of language as a factor explaining the structure of important cultural markets and the position of "new societies," such as Canada, in the global cultural economy. (1994: 377)

Collins notes that the development of an open economy and cultural free trade is often perceived as economically and socially damaging because it threatens the prosperity of information producers, the cultural levels of the population and the cohesion of society itself. (379) Recognizing that cultural exchange and trade in cultural goods has prevailed since Gutenberg's time, Collins suggests that what has changed is the pace of change and the acceleration of the dematerializing of cultural commodities. (383) Formerly, the main issue posed by the international circulation of culture was freedom of information, but now there are issues of economic interest and the desire of communities to assert their distinctiveness from other collectivities. "Thus...accelerations in the rate of cultural exchange and adulteration are profoundly troubling to societies

based (as all must, to some extent, be) on common cultures and collective identities, and the reverse to societies based (as all must, to some extent, be) on universalistic and rational principles." (383)

Yet, as he notes, there are striking differences in how these problems have been addressed in "old" and "new" societies. (385) Although Canada is a subordinate and peripheral actor in the world's richest and most important information markets, its varied social composition makes it a microcosm of the world community and gives it links to other language communities and markets. These are not necessarily disadvantages. (395) Collins concludes that "It may be that 'new societies' such as Canada possess social structures and habits better fitted to the brokering roles increasingly required in an increasingly interdependent and internationalized world economy than do old-style nation states." (396)

As previously noted in *Vital Links* (1987), there is a need to join creators with their audiences if Canada's cultural industries are to flourish. Liss Jeffrey's paper, "Rethinking Audiences for Cultural Industries: Implications for Canadian Research," deals with some of the fundamental questions for researchers of Canadian audiences for the cultural industries within the context of international developments. She notes that in Canada, as elsewhere, conflicting assumptions about audiences underpin all aspects of cultural and economic development, including the appropriate limits of unregulated markets, the state's role in supporting cultural industries and producers, and the negotiations over the exclusion of cultural industries from international trade agreements. (1994: 496) She suggests that more focussed and refined audience research will help to clarify some of the conflicting values that animate trade disputes.

Two basic approaches to knowledge of audiences are outlined – the economic approach (market model), which defines audiences as consumers, and the cultural approach (public model), which defines audiences as composed of citizens. (496-498) Relevant considerations of the first approach include marketing concerns: product, price, placement and

promotion. Those of the second approach include democratic values, education, public health and community safety, literacy and quality of community life. (496-498) As Jeffrey sees it, the main problem for advocates of the cultural approach is that cultural concerns are often qualitative – quantification is difficult but possible and not always meaningful. For example, how do you measure the effects of the repeated invasion of one culture's imagination, national identity and sovereignty by the mass media of another culture? (497-498) She feels that both quantitative and qualitative research is required to illuminate these matters and argues that neither element can be ignored if audience research is to contribute fully to debates over cultural and economic development. (498)

Her paper goes on to address six key themes that reflect a substantive rethinking of the nature and meaning of audiences: questioning of the validity of current audience measurement systems; inadequacy of our knowledge of what audiences actually do; fragmentation of mass audience due to increased choice; search for a distinctive calculus by public sector broadcasters; new research emphasizing the active nature of audiences; and examination of the fundamental assumptions animating debates over national identity and the impact of foreign broadcasters. (499-515) In addressing this last issue, Jeffrey notes that the Canadian case is of particular interest. Despite a highly advanced technological infrastructure, Canadian producers of English-language television programming have experienced repeated problems in reaching domestic audiences. (515) For Jeffrey, the key question is what sort of linkage exists between exposure to the media and cultural and national identity, particularly in a context where cultural consumption is not coercive. (514)

The paper concludes by briefly sketching the implications of the current rethinking of the nature of audiences for Canadian researchers. Jeffrey suggests that basic assumptions about both the "market" and "public" models need to be questioned, as do our assumptions about audience behaviour. Economic issues have dominated cultural industries research to the detriment of

less measurable questions. "The programmatic call is for an audience model which carefully balances the claims and assumptions of market and public models. A clearer public calculus in which diversity is highlighted is urgently required, but this will not be fruitful in the absence of sustained attention to audiences as consumers." (518)

As the editors of the volume (McFadyen et al.) point out in their introduction, the central theme emerging from these papers is the tension between cultural objectives and commercial considerations:

> The inherent conflict between these two goals underlies much of what has occurred in the past in Canadian cultural industries research and policy-making. It will become even more important in the future as a result of the convergence of the broadcasting, telecommunications, and computer industries (popularly titled the "information highway"). (257)

In October 1997, culture and trade were again the central focus of a conference, organized by the Centre for Trade Policy and Law in Ottawa. The proceedings were later published as *The Culture/Trade Quandary: Canada's Policy Options*, edited by Dennis Browne. The conference dealt with four main themes: the social and economic rationale for domestic cultural policies; the impact of technology and technological change on our cultural industries; the treatment of cultural goods and services in international trade law; and the impact of globalization on culture and national identity. As Browne noted in his foreword, in recent years differences in perception between the Canadian cultural community and Canadian trade officials had driven a large wedge between the two communities. The conference was intended to bring them together for a frank and open discussion of the serious and increasing international challenges to Canadian policies. (1998: vii)

In his paper entitled "Social and Economic Rationales for Domestic Cultural Policies," Victor Rabinovitch (then Assistant Deputy Minister of Cultural Development in the Department of

Canadian Heritage) begins by illustrating the predominance of foreign content, mainly American, in Canada's cultural marketplace, citing the following statistics: 70 percent of music played on Canadian radio stations, 60 percent of all English-language television programming and 33 percent of French-language television programming, 70 percent of the Canadian book market, 83 percent of the newsstand market for magazines, 84 percent of retail sales of sound recordings, 95 percent of feature films screened in theatres, 86 percent of prime-time English-language drama and 75 percent of prime-time French-language drama. (1998: 30) He goes on to explain that the Canadian government has intervened in the cultural sector to achieve two fundamental objectives: "the development of cultural content and access to cultural content." (32) His concept of "cultural content" includes "categories of intellectual activities such as the reporting of news, information, analysis and debate, and the advancement of scholarship, as well as promotion of the performing, creative, and visual arts and entertainment." (32)

Quoting remarks made by the Minister of Canadian Heritage, Rabinovitch notes several observations flowing from recent experience in dealing with the emerging challenge of how to relate cultural objectives and trade and investment objectives:

1) A strong and viable domestic cultural base is the primary goal, and the Canadian market remains the primary audience for the products that are assisted through Canadian cultural policies.
2) Culture is not about the creation of a commodity or a service to be traded, promoted or invested in without regard for the sustainable diversity of cultural expression.
3) International trade agendas and regional economic co-operation agreements present major challenges to the survival of global cultural diversity.
4) Trade challenges are not the best way to examine the rationale for cultural policies and national cultural objectives.

5) Retaining a formal sovereign right to develop cultural policies is no longer adequate if program and structural measures put in place by a country are constantly assessed (or challenged against the standards set for trade in commodities or services}. (41-42)

Rabinovitch also makes the important point that while there are significant economic benefits from cultural activities in terms of direct employment, investment, tax revenues and indirect services, the fundamental impetus for cultural policy "is the need for identity, cohesion and avenues of expression that are part of the foundation of an enduring society." (38) He believes that Canada's cultural objectives are as important as foreign and trade policy considerations and that foreign policy is intended to be an extension or a projection of domestic policies and interests. (42)

In her presentation, "The Impact of Globalization and Technological Change on Culture and National Identity: A Call for Visionary Pragmatism," Liss Jeffrey contends that Canada should take a leading role in a multilateral effort to ensure the reversal of the trend to incorporate culture into economic trading regimes. (1998: 159) She views the cultural exemption in the FTA/NAFTA as an unwise trade-off, because existing rules are futile in resolving cultural industries disputes in international trading regimes. What is required, in her view, is a viable framework at the level of the nation-state to implement a counter strategy of "visionary pragmatism."

For Jeffrey, trade is not an end in itself, but the means to a higher quality of life. Culture – involving as it does the felt sense of a public communication space within which multiple identities can find a place – informs our civil values and makes possible our evolving democracy and quality of life. Within this vision, specific cultural, linguistic and racial communities can find room to grow and flourish with a distinctive Canadian framework for diversity with unity. (160)

> The wisdom of the Canadian position taken in the 1920s, and continued into the present through national ownership, regulatory, tax, and other policies, is that

communications technologies and culture have always been linked to building national networks to ensure the nation's conversations. During the 1990s, cultural policy is shifting the agenda and this shift needs to take full account of the problems with the economic trading regime approach to culture, and the emergent digital media and multipath networking. The rationale is twofold: Canada should prepare itself for the digital convergence of the major Canadian cultural industries, telecommunications, broadcasting, and publishing; but, also, Canadians should continue to insist that their governments design a strategy that reflects their interest in ensuring access for all to a public communications space. (176)

Jeffrey concludes:

Beyond keeping culture off the table, at the intersection of trade and cultural policy the most significant threat to Canada's communication space on the horizon will likely emerge from the difficulty in maintaining the separation of the cultural industries, which are ostensibly exempt from NAFTA, from the non-exempt telecommunications sector (Acheson and Maule 1996, 84-85). For the time being, Canada must insist that an operation that acts like a broadcast distribution undertaking, such as WebTV, be regulated under the Broadcasting Act. Otherwise, the ability to design policies to suit Canada's historical cultural aspirations will be abandoned by definition. (180)

In her paper, "The Impact of Technological Change on Canada's Cultural Industries," Sheridan Scott describes how the technological changes occurring in Canada's cultural industries are hastening the development of new media, namely interactive video, audio and text-based services rooted in the convergence of telecommunications, computing and broadcasting. These changes are also challenging traditional economic and regulatory models for the cultural industries and underline the need to develop new models to ensure that Canada continue to

maintain and promote national sovereignty and to foster economic growth. (1998: 55) Citing the arrival of unauthorized, American-based direct-to-home services to Canadian customers and new media services carried over the Internet, she notes that as a result of technological change, geographical boundaries are increasingly less effective as regulatory points of control. (66-67) She also predicts that as new technologies lead to greater programming choices, there will be greater opportunities for content providers, and as content becomes more directly available to consumers, access will be controlled more and more by individuals than by regulators. Thus, she believes, a new approach for fostering Canadian content will have to be developed – one based more on promotion of Canadian content than on protection. (81-84)

Scott suggests that with the appropriate government policies aimed at encouraging and supporting new media, technology has the potential to very positively affect the development and distribution of Canadian cultural content. (83) However, she does not believe that using public policy to regulate the "cultural" growth of new media is the way. (82) Rather, she advocates a public policy economic intervention that would include a number of elements: continuing incentive and investment programs for traditional entertainment content such as the television production fund; encouraging conventional broadcasters to take advantage of digital production, quickly resolving issues surrounding digital transmission; not subjecting new media and Internet content to a traditional licensing regime, thus encouraging growth and enabling Canadian producers and distributors to take advantage of new economics of production and distribution; encouraging Canadian content developers and distributors to improve marketing of all types of Canadian programming; and encouraging the establishment of diverse funding sources for new media content aimed at fostering innovation in content and promoting synergies between creators of both traditional and interactive digital products. (84)

It is this "balance of current and new incentives, and a deregulatory approach to new media" that she believes "would appear to offer the best potential to encourage more production and more consumption of Canadian-produced content across the entire audiovisual spectrum." (84)

As Ivan Bernier remarks in the introduction to his paper, "Cultural Goods and Services in International Trade Law," the debate on Canada's cultural exemption has reached new levels of intensity. The purpose of his paper is to provide a general picture of the way cultural goods and services are currently treated in international trade agreements in order to facilitate the search for new directions. (1998: 111) After tracing the fundamental legal differences that exist between the treatment of goods and services, Bernier examines their treatment in the context of the WTO and NAFTA, under the investment provisions of the OECD, WTO and NAFTA, under bilateral investment agreements and finally under the intellectual property rights provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and NAFTA.

Bernier's survey of the various agreements demonstrates that there is still a great deal of ambivalence about the treatment of cultural goods and services, based on the fundamental question of the specificity of these goods and services. (146) Are they goods and services like any other, or should they be treated differently? Unfortunately, according to Bernier, there is no obvious answer:

> What is needed in reality is a twin-track approach that would recognize that cultural products, to the extent that they are traded, come under the ordinary rules of international trade agreements, but at the same time would make it possible for states to intervene in order to ensure a viable domestic cultural production and to favour better access to a diversified foreign cultural production. In other words, an approach that would distinguish between the industrial and the cultural objectives of government intervention. (147)

For Bernier, such an approach at the international level would not necessarily mean excluding cultural products from international trade agreements altogether, but rather would mean finding ways to permit derogation by signatory countries in defined circumstances, such as those used for general exceptions in the GATT 1994 and the General Agreement on Trade in Services (GATS), or for country-specific reservations such as in NAFTA. (147-148) Either way, Bernier feels that it is clear that the issue of treatment of cultural products in international trade will not go away:

> Canada, in that context, has a crucial role to play as the leading advocate of cultural exception clauses. Unless something like this is done, chances are that internationalization will win the day without even a serious debate on the issue, which would be too bad not only for the preservation of cultural diversity, but also for international trade itself. For diversity, including in a very fundamental way cultural diversity, is the essence of trade. (148)

In a 1997 monograph entitled *A Matter of Choice: Toward a More Creative Canadian Policy on Culture*, published by the C.D. Howe Institute, Daniel Schwanen examines Canada's current cultural policies in the context of further trade liberalization, the unfavourable WTO decision on Canadian measures to support the magazine industry as well as other pressures such as government budget constraints, Canada's growing international presence culturally and the rapid pace of technological change. In response to these pressures, he calls for a renewed focus on the objectives of Canada's cultural policy.

The underlying rationale for direct government intervention in support of culture, according to Schwanen, is the need to ensure that Canadians can share experiences and information about Canadians and Canada. However, he feels this direct intervention must be accompanied by steps that ensure a well-functioning market for cultural goods and services, including new copyright legislation that would ensure that creators receive a fair share of the benefits from the

dissemination of their work and protection of the public interest. He also believes that the government has a continuing role to play in ensuring that foreign distributors of cultural products do not use market positions gained through economies of scale or vertical integration to shut Canadian products out of the market. (1997: 2)

Schwanen believes that the current definition of Canadian content used for tax, subsidy or broadcasting content rules should be focussed less on ownership and production expenditures and more on creative output and public interest. (2) He rejects the assumption that there is automatically a link between country of ownership of the distributor and the content of the product and suggests that investment rules need to be relaxed. Given the immense size of the "500 channel universe," the content requirements for broadcasting should be replaced over time with a policy ensuring shelf space for signals with high levels of Canadian content across a range of broadcasting technologies. (2) Noting that the WTO panel decision did not imply that Canadian and U.S. products were to be considered "like goods" in a general sense, he suggests that there is a wide range of measures Canada could still adopt to support the production and dissemination of domestic cultural content. Canada needs to obtain clarification through international negotiations on the extent to which subsidies and tax incentives can be used to promote domestic cultural products. (2)

Schwanen argues that our economic interests demand that we participate in freer global trade and investment "because a rules-based economic system actually works in favour of medium-sized economic powers such as Canada by, *inter alia*, permitting the market access negotiated among larger powers to be extended to all, and by establishing a dispute settlement mechanism that is reasonably immune from considerations of relative economic size between disputing parties." (4) These policies also need to be adapted to the new realities that have resulted from rapid technological innovations. (5)

> What is needed is a principled approach to policy in a wide range of cultural sectors, but flexible enough to permit policies to be tailored to fit specific market structures and technology in each sector, consistent with the overall approach. (6)

In her overview of culture and trade issues entitled *The Implications for the Cultural Sector of Harmonization of Economic Policies and Standards*, Rebecca Goldfarb reviews the body of academic literature that discusses harmonization and its implications for the cultural sector, particularly those implications arising from major international trade agreements such as the NAFTA, GATT, GATS and the now-defunct Multilateral Agreement on Investment (MAI) initiative. She defines harmonization as "the process whereby domestic economic policies are altered as a result of an increasingly integrated economic environment." (1998: 6) She divides the academic literature into two basic general frameworks: (1) the cultural view, which she further divides into the "cultural imperialist perspective" and the "nationalist viewpoint"; and (2) the economic view, which she divides into the "liberal economic perspective" and the "institutional perspective." The following is a brief summary of Goldfarb's characterization of these frameworks. (9-18)

The "cultural imperialist" variant of the "cultural view," which assumes the permanent dominance of culture emanating from the United States, traces its origins to Marxism, which sees mass communications as a "system of indoctrination and propaganda" and would characterize Canada as a "dependent capitalist state." From this perspective, much of the development of the cultural industries in Canada is about supporting the interests of American capital, not building a strong indigenous industry.

In contrast to the "imperialist" perspective, the "nationalist" perspective is not fundamentally about dependency but about culture as a tool for nation building, connecting "identity, sovereignty and unity to the production of domestic cultural products." (11) Nationalists generally express a concern that

cultural industries in Canada have been more concerned with profit than with the creation of Canadian content. The problem, therefore, is less the result of American cultural imperialism than about conflicting domestic values. (13)

From the liberal economic perspective, while free markets and minimal state intervention are desirable, liberal economists generally do not oppose a role for government in the creation of culture, albeit a much more circumscribed role than the government currently plays in Canada. Goldfarb links the growing interest in minimizing state involvement in all sectors to a global trend that began in the 1980s, a trend that has been difficult to follow in Canada because of the long-held belief by "nationalists" that culture contributes to political stability and national unity. (15) The liberal economists question the link between culture and "cultural products" and make a clear distinction between harmonization of economic policies and harmonization of culture.

The "institutional" variant of the "economic view" sees Canadian policy as a combination of responding to the forces of globalization with free trade promotion and some form of cultural protection to achieve a desired level of Canadian content. From the institutional perspective, the current state of affairs, with a non-regime for culture, is untenable. Culture is assumed to be on the negotiating table. Institutionalists feel a rules-based system negotiated in international trade agreements (regimes and institutional) will ensure better trust, understanding, stability and security, ultimately making it easier for Canada to achieve its policy objectives in the cultural sector. (17)

Thus, it is not surprising that adherents of the cultural and economic perspectives found so much to disagree about in the FTA and to a lesser degree in the NAFTA. The utility of the cultural exemption, negotiated in this agreement under FTA Article 2005(1) and repeated in the NAFTA Annex 2106, has been the focus of much of the debate. Depending on one's perspective, the cultural exemption can be viewed as either irrelevant because the United Sates has the right to retaliate with

"equivalent commercial effect" (19), or successful because it has never had to be used. (19-20)

From the economic perspective, non-use of the exemption is seen as evidence that "liberal institutionalism can allow for effective international rules and norms that will allow nations to maintain domestic policy choices." (20) Some liberal economists also suggest that the current mechanisms for protection, including the exemption, should be modified because the exemption creates a "misallocation of resources within Canada, enabling the government to play a role where it should not." (20) Others suggest that a rules-based trading system results in principles, norms and rules that are transparent and predictable rather than a regime that is neither transparent nor predictable. (20)

Goldfarb briefly discusses another issue emerging in the recent literature on the trade and culture debate – the determination of what is defined as a good and what is defined as a service – a distinction that is important because it determines whether GATT 1994 or the GATS will be applied in a particular instance. (22) Using the WTO ruling against Canada in the case of split-run magazines as an example, she points out that "the current rules, norms, principles and decision making procedures are somewhat uncertain, with respect to cultural goods, because services can be embedded in goods." (23)

Briefly turning to the question of subsidies in the cultural sector, Goldfarb suggests that if subsidies are not allowed or limited under trade regimes there is a danger that "cultural industries will become less able to promote a distinctly Canadian product." (23) She finds both economists and culturalists in general agreement that, if Canada chooses to protect culture, subsidies may be the best option. In terms of intellectual property, she notes a difference in the basis of copyright law in different trading partners. For example, economic rights have been the basis of copyright law in the United States, while moral rights form the basis for intellectual property rights in other countries. Thus, an exclusion of moral

rights from the NAFTA and the WTO is seen by many as a further industrialization of culture. (24)

Goldfarb observes that debate during the discussions prior to the abandonment of the MAI replicated many of the same positions being taken prior to the signing of the FTA and focussed on what kind of exemption would be best – a self-designed cultural exemption as advocated by the French or a country-specific reservation favoured by Canada. Goldfarb believes a shift in outlook from the cultural to the economic has taken place. There appears to be a growing acceptance of both the reality and the benefits of global trade agreements. Thus, the focus of discussion has become more analytical and has shifted to the implications of specific conditions contained in the agreements. (26)

Much Ado about Culture: North American Trade Disputes, by Keith Acheson and Christopher Maule, is the latest major work (388 pages) to examine the differences in approach to culture in Canada and the United States and to trace the resulting conflicts in the context of technological developments as well as international agreements dealing with trade, investment, copyright, and labour movements. The nature of the Canadian cultural industries is examined, as are several cases of recent conflict. The authors also propose an alternative approach to the current cultural exemption in the FTA that would allow the gains from openness to be realized while responding to legitimate cultural concerns. In the interests of brevity, I will confine my summary of their views to the concluding chapter of the volume.

Briefly stated, Acheson and Maule argue that Canada's protectionist policies have been ineffective in changing American dominance of cultural industries. In their view, cultural industries are essentially international, and therefore protectionist policies make little economic sense, particularly for small countries (markets), because protection reduces wealth when producers are barred from the larger, dominant market. These policies have also failed in their objective to ensure more Canadian content. (1999: 331-333) They feel that both large and

small countries need to achieve both access to and success in foreign markets in order to support their domestic production. "The best way to assist domestic industries, cultural and other, is to ensure that they are internationally competitive. The worst way is to condemn them to small domestic markets and to prop them up with subsidies." (334) While admitting that protectionist cultural policies are politically popular, Acheson and Maule predict that the popularity of these policies with voters will wane as dissonance increases between what is promised and what actually happens. (334) They also question public statements that emphasize American global dominance of cultural content, suggesting that a more appropriate description of the current situation would be "the dominance of the production and distribution of international content by a system that is also international." (335)

Acheson and Maule feel that the general acknowledgement that what we read, listen to, or watch matters does not justify policies that prohibit or make more expensive content based on criteria that do not relate to the content itself. Yes, Canadian voices are being subsidized and protected, but are Canadian stories being told? (335) In their opinion, the themes – "Americans against us," "the benefits of unspecified cross-subsidies," the "Canadian voices need a public space to tell Canadian stories" mantra and the "importance of ownership" – have been cultivated by a mix of interests – industrial, bureaucratic and political. (338) They predict that the willingness to pursue these policies will be reduced as access to foreign markets becomes more important than domestic protection and as the enforcement of protective barriers becomes more difficult; and that continuing with current cultural policies will result in retaliation and the stifling of exports, a major source of success for many cultural industries. They feel that this approach is unattractive to consumers and may also result in an exodus of talent. (338)

As an alternative approach to the current policy of protectionism, one that would allow the gains from openness to be realized while responding to legitimate cultural concerns,

Acheson and Maule would draw on the examples of the special arrangements contained in international agreements dealing with other sectors such as agriculture, textiles, steel, aircraft, financial services, etc. Under these arrangements, individual goods have been conditioned by voluntary export and import restraints. (338) While they appear to resist freer trade, these special arrangements frequently prevent the introduction of further protectionist measures and include procedures that will lead to future liberalization. Acheson and Maule feel that such an arrangement for cultural industries could be designed to result in outcomes of mutual benefit. (339) Specifically, they favour a formal agreement that would include cultural and entertainment goods and services within the framework of the WTO with limited special provisions for particular circumstances, similar to the approach taken for telecommunication services, where a reference paper set out the definitions and principles for the sector's peculiarities. (346-347)

Developing such an agreement would require a number of steps:

- drawing the boundaries for the inclusion or exclusion of relevant activities in a way that would permit the impact of future technological development to be taken into account;
- determining the scope of the agreement with respect to trade in goods, services, investment, intellectual property, and the movement of persons;
- identifying factors affecting access by foreign firms to domestic markets;
- developing a list of subsidies and tax incentives affecting the industry;
- developing a list of private actions that affect trade, and identifying the scope of antitrust policy to deal with these policies from a trade policy perspective; and
- examining alternative dispute resolution procedures. (347)

They also suggest the following goals to which the sequence of commitments should aspire: no tariffs and quotas, minimal foreign ownership restrictions, non-discriminatory market access, freedom to work, co-ordinated enforcement of national antitrust laws, no direct or indirect protection of wholesale or distribution networks, national treatment in the application of censorship, national treatment of programming in "safe sanctuary" periods of the day, subsidies allowed to fill "gaps" in content, and national treatment in tax provisions and transparency. (347-348) They conclude by noting that even if a sectoral agreement is not the preferred route, these issues will still have to be addressed. (348)

A growing number of observers in the United States also question the current U.S. government approach to culture, as reflected in international trade negotiations, and are examining alternative approaches to deal with difficult trade/culture issues. For example, in a 1998 article, "Defending the Imaginary to Death? Free Trade, National Identity, and Canada's Cultural Preoccupation," Oliver J. Goodenough, like Carr (1991), traces the roots of the recurring Canada-U.S. friction over trade and culture to a conflict in ideals or "defining national myths" – the importance of protecting a national identity for Canadians versus the principles of free speech and free markets for U.S. citizens. (1998: 207) He feels that this makes it difficult for many Americans to step outside the parameters of their ideals to ask themselves whether protection and interference may be required to protect some things of social value. (206) He feels that Canadians, on the other hand, tend to ignore these underlying American ideals and see only the business aspects of the dispute. (207) He also notes that disputes are rarely over "high culture" (opera, ballet or the fine arts) or "ethnic culture" (folklore, traditional arts and architecture), but over "popular culture" – film, television, music, mass-market books and mass-market periodicals. (209)

In reviewing Canada's legal framework for the promotion and protection of its cultural autonomy, Goodenough observes a "certain schizophrenia" underlying both "strong" measures

aimed at excluding U.S. products and weak ones ensuring choice, including: prohibitions, penalties and quotas on foreign products, investment regulation, the cultural industries exception in the FTA and NAFTA, its treatment under the GATT, and subsidies and incentives for Canadian cultural industries. (211) Faced with the recent discouraging rulings against Canada by the WTO, Goodenough feels that the pertinent question is "not about what the interaction of national and international law may be construed to require, but rather about what it should require." (222)

In making a case for the protection of culture, he explores four analytical arguments. (223-230) First, he suggests that cultures naturally defend themselves. "If the link between culture as 'product' and culture as 'value system' is indeed strong, then the theory of cultural transmissions may help to legitimize Canada's struggle. Cultural systems will generally contain self-protective responses against external forces of change. Therefore, the Canadian measures can at least claim to be implementing common, natural and perhaps necessary cultural and psychological tendencies." (223-224)

Second, he argues that the U.S. position as a model of free trade on cultural matters is flawed. (224-225) For example, U.S. broadcast television, radio and newspaper ownership restrictions limit foreign interests to not more than 20 percent, using the rationale of national security. (224) Third, he asserts that a great deal of U.S. cultural production exploits emotional manipulation for the purpose of creating further paying demand for more of the same. Therefore, "the popularity of United States cultural product is not just the result of economies of scale, or the dominance of the English language internationally, although these are not trivial elements. The U.S. product is also popular because it is made by an industry which values popularity, and which under the legal regime of its native land has the creative license to pursue popularity, with very few legally-imposed constraints promoting a 'better' diet." (226-227) He suggests that "Canada's measures to counteract a drivel infestation are almost all *origin* driven and *content*

neutral...Nonetheless, if content is the concern, *geographic source* restrictions are at best an oblique way to pursue it." (227)

Finally, he argues that "free trade principles must be sacrificed in some contexts to help preserve the societal underpinnings on which the possibility of free trade ultimately depends." (223) There are costs to maintaining a civil society, and cultural protectionism is one of them. At the same time, Goodenough wonders if Canada's cultural protection policy really does what it claims to do and suggests, "If exclusion is the goal, most of the measures do not currently work, and this failure will likely get worse; if choice is desired, the measures largely exclude a prime potential source of choice: American-owned but Canadian-oriented products." (230)

Goodenough also suggests that exclusionary prohibitions of U.S. cultural products can in some ways be viewed as undemocratic and highly suspect because they suggest that Canadians cannot be trusted to make the right choice in the popular culture they consume. (235) He believes that the real divide is between the two realms of culture (high culture versus popular culture) and not between the United States and Canada. "Supporting these endeavours [opera, ballet, novels and fine arts] with public money may be a good idea. Limiting access to the Disney Channel, however, will have little impact on the strength of Canada's high culture institutions and artists, although such a limitation is likely, over time, to weaken the popular appeal of Canadian animation." (237)

While accepting that there are different ways that Canadians and Americans view many aspects of the world, and that there is good empirical evidence that there are distinctive Canadian attitudinal traits whose strength is increasing, he wonders if protectionism is irrelevant because, at the level of popular creative works, there is such a great deal of sharing across English-speaking North America. (239) Citing cultural transmissions theory, he suggests that "most foreign influences will 'bounce off' a healthy culture without government intervention, or at the very least will be compartmentalized for

use in contexts separate from hearth and home. Where the link between exposure to foreign product and a change in domestic values is weak, there is little to worry about. On the other hand, the penetrating ability of those that do not 'bounce off' will be little affected by government-level efforts to keep them under quota." (241)

In the concluding section of his paper, he suggests it is time for a "new strategy built around subsidies and constructive engagement with the United States." (247) Rather than fighting Hollywood, Canadian policy should be to look for ways to work with it. "Xenophobia and strong protectionism on the ownership front may well be getting in the way of making popular and widely-seen Canadian content films and television programming. When it subsidizes Canadian owners rather than Canadian product, weak protection does not work either." (247)

Writing in *Business Week* (November 1998), Jeffrey E. Garten, Dean of the Yale School of Management, calls on the government and on corporate America to lessen U.S. cultural dominance by encouraging cultural diversity around the globe. He urges the U.S. government to reverse current trade policy and permit temporary quotas and subsidies abroad to preserve certain local cultural industries. He also urges multinational corporations themselves to fund native entrepreneurs wishing to create cultural industries, to showcase regional film and theatrical productions and to finance university research and teaching of history, art and literature. (1998: 26)

He concludes his article with this warning: "Protecting national cultures could soon become a defensive rallying point for societies buffeted by globalization and undergoing tumultuous change. Being more sensitive to foreign concerns would ease the prospect of back lash and even bolster America's ability to export its ideas and ideals for the long haul." (26)

As mentioned previously, cultural industries are the means of communication, the conduit to the Canadian public, for the cultural goods and services produced by Canadians about Canada. The direct impact that freer trade has on the well-being of this sector of the economy has a secondary impact on the distinct Canadian identity it is meant to create, support, preserve and protect. This leads our discussion to a second set of questions about trade and culture: Is trade having an impact on national identities? How different are our values from those of our major trading partner? Is trade liberalization affecting the legitimacy of the nation-state as a repository of distinctive, common cultural values?

In his comparative study, *Continental Divide: Values and Institutions of the United States and Canada*, Seymour Martin Lipset notes that, despite the development of both countries into industrialized, wealthy, urbanized and ethnically diverse societies, the dissimilarities, particularly the cultural differences, of the past continue. "To reiterate an analogy, the two are like trains that have moved thousands of miles along parallel railways tracks. They are far from where they started, but they are still separated." (1991: 212)

Lipset feels that despite trade liberalization Canadian values have survived what is already an American-dominated mass cultural market. "Given modern means of communication, the diffusion of mass media, and easy travel, the tenacity of cultures – their ability to hold on within merged economies and polities – is amazing." (221-222) Lipset also believes that the cultural and political differences between the two nations help to explain their occasional difficulty in understanding each other in the international arena. (220) "Americans, more than other western peoples, tend to view international politics in non-negotiable moralistic and ideological terms. Canadians, like Europeans, are more disposed to perceive international conflicts as reflections of interest differences and, therefore, subject to negotiation and compromise." (220)

Lipset goes on to note that perhaps the most important step that Canada has taken to Americanize itself – far greater in its implications than the signing of the free trade treaty – has been the incorporation into its Constitution of the Charter of Rights and Freedoms, which places the power of the state under judicial restraint. (225)

In a more recent discussion of North American values, *The North American Trajectory: Cultural, Economic, and Political Ties Among the United States, Canada, and Mexico*, Ronald F. Inglehart, Neil Nevitte and Miguel Basanez examine how changes in basic values in the United States, Canada and Mexico are transforming economic, social and political life, resulting in an increasingly compatible cultural perspective among them. Their findings were based on a comparison of cross-national surveys carried out in 1981 and 1990. They observe that, generally speaking, as old economic boundaries are becoming eroded, a narrow 19th-century nationalism is gradually giving way to a more cosmopolitan sense of identity. (1996: 1-2) The authors feel that these changes are rooted in long-term generational differences and for this reason they will probably endure, and their cumulative effects will likely be massive. (167)

One of their concerns is the interplay between economic forces and human values. They feel that economic prosperity is an instrumental goal, not an end in itself. They note that "Free trade is a hotly debated issue not just because it leads to redistributive economic conflicts but also because it brings into play dilemmas grounded in the tension between two imperatives: the drive to attain economic prosperity through maximizing economic efficiency, and the drive to achieve noneconomic human goals. Economic welfare is one horn of the dilemma, with a nation's status and autonomy being the other." (35) In Canada, free trade with the United States is controversial because Canadian and American national values seem so similar that Canadian identity is threatened. Canada has a fragile national consensus, one fractured by historical linguistic, cultural and regional divisions and further aggravated

by contemporary political disputes about how those cleavages should be constitutionally managed. (35) Yet, as noted in this survey of public attitudes to freer trade in all three countries, Canadians and Mexicans are clearly more eager for freer trade than are Americans themselves. (44)

While the authors do not suggest that political union is imminent, "One provocative implication that flows from these findings is that the traditional, historically entrenched rationale for the existence of political borders separating the three North American countries seems to be eroding." (171) However, citing the examples of Canada, Switzerland and the Soviet Union, they find little evidence that doing away with political borders will mean the disappearance of cultural differences. (171) They also question the assumption that comprehensive free trade will result in the standardization of public policies. As their findings indicate, a clear majority of citizens in all three countries want publicly funded health care – thus, they anticipate a policy harmonization away from and not toward the current American standards. (171) Contrary to some fears expressed during the negotiation of the NAFTA, they do not find any evidence that the Mexican public is more likely to sacrifice environmental standards for economic prosperity, even if this has not automatically translated into public policy. (171)

Their study suggests that some of the most basic values of the United States, Canada and Mexico are gradually changing – on a common trajectory, moving in the same direction, but not converging toward a common model, which is the United States. Indeed, in many respects Canada is ahead of the United States, though moving in the same direction. (81) What they feel is happening is not the Americanization of North America, but a common response to global forces. This process is frequently misperceived as Americanization simply because the United States is the mass media centre of the world, and the symptoms of change are often detected and publicized first in the United States. In reality the three societies are converging toward a model that none of them has yet attained. (162) "What we seem to be witnessing is neither divergence nor

Americanization, but a complex process of modernization that is changing all three societies in a broadly similar fashion." (81)

Michael Adams comes to similar conclusions in *Sex in the Snow: Canadian Social Values at the End of the Millennium* (1997). Using annual survey data on social values gathered by Environics Research since 1983, Adams uses a multivariate clustering and mapping technique to plot psychographic stereotypes or groups on a two-dimensional grid: (1) individual versus social inclinations; and (2) traditional versus modern values. The result is a "psychographic geography of Canada" that aims to portray the diversity of the Canadian character.

In comparing Canadian values data with those for the United States, Adams asserts that the "socio-cultural differences between Canada and the United States, like the differences between Quebec and the rest of Canada, or even between men and women, may be diminishing over time, but the differences that remain will...be significant and meaningful for many generations to come." (178) In his opinion, "although economic integration continues apace, there has been much less socio-cultural assimilation of Canada by the United States than is often feared. In important ways Canadians and Americans live different sorts of lives. Moreover...such assimilation will not take place for many generations to come, if ever." (194) He finds that French Canadians and English Canadians have more in common with each other than either group has with Americans. "And in spite of our growing intimacy with American commerce and culture, Canada remains a distinct society on the northern half of the North American continent." (195)

A less sanguine view of the threat to national identities posed by economic integration has been taken by many European commentators who see the Americanization of the world's culture as a clear and present danger. One particularly outspoken opponent of this perceived threat is Ignacio Ramonet, editor-in-chief of the journal *Le Monde Diplomatique*, who has collected a series of his essays on globalization together in one

volume entitled *Geopolitics of Chaos* (translated from the French by Andrea Lyn Sacara).

According to Ramonet, Europe is confronted by three serious crises: an economic crisis, a demographic crisis and a cultural crisis. (1998: 142) He notes that since 1954, when European television became a reality, Europe has been inundated with American mass culture. "A new civilization took shape whose matrix, developed in the United States, is – for the first time in two millennia – foreign to Europe." (145) He feels that increasing globalization of the economy and of culture has further blurred the national framework. Stripped of essential cultural reference marks, and having lost their identity, people are facing the current crisis under the worst mental conditions. (137-138) Furthermore, "the logic of the market, free trade and the search for maximum profit, are threatening the cultural and creative domains." (149) In this respect, he finds WTO negotiations that include fields related to cultural production – audiovisual and cinematographic sectors – disquieting. (149)

While acknowledging that new technologies offer great creative opportunities, Ramonet fears that the United States' quasi-absolute domination of these technologies may lead to new forms of dependence and a condition of cultural vassalage. "World culture – in English – is spreading on a planetary scale and is imposing itself everywhere, not only in the countries of the South, but also in Europe." (154) Freedom of expression is being set in direct competition with the "freedom of commercial expression," which is sometimes presented as a new "human right." (158) "The doctrine of globalization equates freedom, plain and simple, with the freedom to do business." (158) The central idea in this new doctrine is expressed in roughly these terms: "Let people look at what they want to. Leave them free to enjoy. Trust their common sense. The only sanction applied on a cultural product must be its failure or its success in the market." (159)

For Ramonet, the final result of globalization of the economy, "preventable but already palpably present, is a

combination of three dynamics that are converging explosively upon humanity at the end of this century. They are: globalization of the economy, the ultimate avatar of Western modernity, dating from Europe's world-wide expansion in the 15th century; reducing the role of the State – which may ring the death knell of politics and civil society all together; and the generalized destruction of cultures, North and South alike, by the steamroller of communications, mercantilization and technology." (58)

Economic Integration – Social Disintegration?

In addition to the fear that cultural identities are threatened by economic globalization, a growing number of observers are expressing concern that the integration of economies around the world is leading to increasing pressures on the "social contracts" that hold these societies together. Some critics see international trade agreements as creating more social inequality in our society and posing a threat to basic social policies, programs and solidarity. This leads us to a third set of questions about trade and culture: What are some of the short and long-term impacts of trade liberalization on social cohesion? What role can the state play in preserving social cohesion in the context of a global economy?

As the recent report of the Senate Committee on Social Affairs, Science and Technology, *On Social Cohesion*, indicates, governments and business are under pressure to start thinking more about the longer-term societal implications of economic policies such as trade liberalization. The key question posed by the committee was: "What forces will hold Canadian society together in an environment shaped by intense global competition and fast-moving technological change?" (1999: 2)

The report cautions that "for many in government and in the business world, the standard approach to globalization is to emphasize the benefits of the free flow of goods and capital, and to overlook the social fallout that may result. For too long,

we have assumed that short-term social costs could be offset against long-term economic gains. What we forgot to take into account was that social damage could itself frustrate economic objectives." (10) The report also warns that the political consensus in favour of policies designed to enhance economic efficiency and growth could easily evaporate if the sacrifices and social costs are seen to fall primarily on the poorest and weakest segments of society, and the benefits are enjoyed by others. Unless they feel some stake in economic growth, they are likely to withdraw their support for free trade, capital mobility, relatively open immigration, deregulation and other similar features of open economies. (9-10)

The Senate committee observed that for many Canadians, globalization is exposing social fissures between those with the education, skills and mobility to flourish in an unfettered world market – the apparent "winners" – and those without. Social disintegration is not inherent in globalization. However, since liberalization exposes domestic producers to volatile global markets and to capital flows that are large relative to the economy, it increases risks – but it also increases potential rewards. For social cohesion, the challenge is to identify policies that enable those left behind to participate in markets on more equitable terms, nationally and globally. (10)

The report notes that until recently, most experts and policy makers in government believed that there was a trade-off between social and economic issues, between social justice and economic performance, between market and society. The report cites recent evidence from international research demonstrating that more equal societies are likely to be more prosperous in the long term and to have higher levels of well-being. (10) Equality has a positive impact on investment, both in human capital and in physical capital. (12)

The report's authors feel that the rise of transnational corporations has delivered "a significant blow to social cohesion and to the post-war social consensus." (17)

> Ownership of such corporations is increasingly spread among several nations, and the various components of

> major products are each produced in different countries. They operate on a world-wide or global footing. They have no nationality and are not rooted in any local or national communities. Today, in the new global economy, corporations and those who manage them are not as economically dependent on the local or regional economy as they once were, and thus have less self-interest in insuring the well-being of citizens. (17)

The report also makes the point that markets are social institutions, and their continued existence is predicated on the perception that their processes and outcomes are legitimate. Because the international or global market is the only market that is not regulated by an overarching political authority, transactions undertaken in the global marketplace carry the least inherent legitimacy, thus creating an important source of tension between globalization and society. (30) Institutions lacking legitimacy do not function well in the long term. Markets are no different. Therefore, making globalization more responsible means ensuring that the global market operates according to a certain set of rules and institutions that a majority of people see as being legitimate. (36)

In summary, the Senate report contains three key messages:

1) The most serious challenge for decision makers is to ensure that economic integration driven by globalizing markets does not lead to domestic social disintegration.
2) Social cohesion is about shared values, but it is also about redistributional issues.
3) Canadians have choices to make in addressing the socio-economic challenges posed by globalization and technology. (2)

Some academic research and thinking supports the kinds of concerns expressed in the Senate report. A recent National Bureau of Economic Research study by Alberto Alesina, Enrico Spolare and Romain Wacziary, entitled *Economic Integration and Political Disintegration,* links trade liberalization with political separatism. The paper provides a formal model of the relationship between openness and the equilibrium number and

size of countries, and then tests the implications of this model by tracing the process of country formation and succession from the 19th-century formation of nation-states through to the present day. (1997: 18-26)

The findings suggest that in a world of trade restrictions large countries enjoy economic benefits because political boundaries determine the size of the market; therefore, in a world of free trade and global markets, relatively small cultural, linguistic or ethnic groups can benefit from forming small and homogeneous political units that are economically integrated with others. While the authors recognize that national borders still matter, their study implies that, as the process of economic globalization progresses, the trend of political separatism will continue. (25-26) "The concept of relatively large and centralized nation-states is and will be more and more threatened by regional separatism from below, and the growth of supranational institutions from above, in a world of 'global' markets." (27)

Harvard economist Dani Rodrik has examined issues related to globalization, economic integration and social conflict in a number of papers, most notably in his 1997 book entitled *Has Globalization Gone Too Far?* In addressing this issue, Rodrik argues that "the most serious challenge for the world economy in the years ahead lies in making globalization compatible with domestic social and political stability – or to put it even more directly, in ensuring that international economic integration does not contribute to social disintegration." (1997: 2)

Rodrik identifies three major sources of tension between the global market and social stability caused by economic integration. First, he points out that globalization may result in increasing asymmetry between groups that can cross national borders and those that cannot (owners of capital, skilled workers and professionals versus unskilled and semi-skilled workers and middle managers). Thus, unskilled workers in one country may find themselves more easily replaced by workers in other countries. (26) Second, globalization engenders conflicts within and between nations over domestic norms and

social institutions that embody them (e.g. workplace practices, legal rules, social safety nets, and labour and environmental standards). This occurs because differences in national social arrangements have implications for trade and investment flows and, in turn, these flows impinge on national social arrangements. (48) Third, globalization has made it exceedingly difficult to provide social insurance. (4-7) He feels that the problem stems from globalization placing increased demands on the state to provide social insurance while, at the same time, reducing its ability to perform this role effectively and, thus, endangering the social consensus required to keep domestic markets open to international trade. (53)

Rodrik does not believe that globalization has gone too far, but he cautions that, if handled badly, the social pressures resulting from global economic integration will result in "bad economics" and "bad government," not only because it will exacerbate tensions between groups, but also because it will reduce the willingness of internationally mobile groups to co-operate with one another in resolving their differences. (70) Globalization "delivers a double blow to social cohesion – first by exacerbating conflict over fundamental beliefs regarding social organization and second by weakening the forces that would normally militate for the resolution of these conflicts through national debate and deliberation." (70) In conclusion, Rodrik reminds us, "The broader challenge of the 21st century is to engineer a new balance between market and society, one that will continue to unleash the energies of private entrepreneurship without eroding the social basis of cooperation." (85)

Just before the WTO meetings in Seattle in the fall of 1999, Dani Rodrik wrote an op-ed article entitled "Five Simple Principles for World Trade." As Rodrik states, "All sides in this acrimonious debate agree that the stability of the international economic system is predicated on a system of global rules. What is contested is the nature of these rules." Rodrik goes on to suggest the principles on which all sides should agree:

- Trade is a means to an end, not an end in itself.

- Trade rules have to allow for diversity in national institutions and standards.
- Non-democratic countries cannot count on the same trade privileges as democratic ones.
- Countries have the right to protect their own social arrangements and institutions.
- But they do not have the right to impose their institutional preferences on others.

In his recent book, *The Lexis and the Olive Tree*, American journalist Thomas L. Friedman also illustrates some of the complex issues relating to globalization, including the impact of globalization on culture, by providing examples from his own first-hand observations of what can happen when societies and the forces of globalization collide. He observes: "When you strip people's homes of their distinctiveness – either by homogenizing them or by destroying them environmentally – you undermine not only their culture but also social cohesion. Culture, at its best, can be one of the most powerful forms of voluntary restraint in human behaviour. It gives life structure and meaning. It sanctions a whole set of habits, behavioural restraints, expectations and traditions that pattern life and hold societies together at their core. When unrestrained globalization uproots cultures and environments, it destroys the necessary underlying fabric of communal life." (1999: 242)

Friedman also believes that the forces of globalization are contributing to the "widespread feeling, particularly within democracies, that even if people have a democracy at home they have lost control over their lives, because even their elected representatives have to bow now to unelected market dictators." (161) Because globalization is creating a single marketplace – with huge economies of scale that reward doing the same business or selling the same product all over the world all at once – it can homogenize consumption simultaneously all over the world. And because globalization as a culturally homogenizing and environment-devouring force is coming on so fast, there is a real danger that in just a few decades it could wipe out the ecological and cultural diversity that took millions

of years of human and biological evolution to produce. (221) The greater discrepancy between a country's cultural norms and the norms of the globalization system, the more wrenching will be the process of adapting to it. (335)

Friedman suggests that one way to mitigate these effects is to practise sustainable globalization. "You cannot build an emerging society – which is so essential for dealing with the globalization system – if you are simultaneously destroying the cultural foundations that cement your society and give it the self-confidence and cohesion to interact properly with the world...My concern is that without sustainable environment there is no sustainable culture and without sustainable culture there is no sustainable community and without a sustainable community the is no sustainable globalization." (243) In a sense, the biggest threat to globalization today is globalization itself. (332)

In a recent address to the Industry Canada Distinguished Speakers in Economics Program, "What's a Country For? Globalization, North American Integration and Social Policy," Keith Banting expressed the view that the evolution of social policy has been shaped by the dual role of the state – domestic and international. (2000: 1) He poses the following questions: "Is it possible to engage fully in the global economy, and still preserve a distinctive national approach to the social contract? Or are competitive economic pressures narrowing the degrees of freedom enjoyed by the state? Are advanced democracies converging on a transnational model of social policy? If this is the case...What's a country for?" (1)

Banting concludes that predictions of an inevitable convergence of social policy regimes are not sustained by the evidence. (5-6) Taking, for example, social spending as a proportion of gross domestic product for OECD countries, he found that convergence was actually stronger in the 1960s and 1970s than it is today. (6) This is not to say that economic integration is irrelevant; however, the overall evidence suggests that the pressures for harmonization or a "race to the bottom" are not overwhelming. (7) Banting believes that while the

constraints are real, they do not represent economic determinism. There is important room for national variations around the common themes of modern life. The extent of convergence between Canadian and U.S. social regimes will depend as much on the evolution of domestic politics as economic imperatives. We need to find ways of re-embedding economic liberalism in a system of social protection adapted to a new century. This will require a return to the language of social rights, although in a form suited to a global era. (13). "What's a country for? It seems that part of the answer remains that it is an instrument for reflecting distinctive domestic cultures and politics." (7-8)

Trade, Culture and the International Cultural Community

As early as the publication of the *Report of the McBride Commission* (International Commission for the Study of Communications Problems) in 1980, UNESCO recognized that intervention was required to achieve a more just and equitable balance in the information flow and cultural expression between larger, wealthier countries and those smaller and less developed. More recently, in 1995, the World Commission on Culture and Development submitted a report entitled *Our Creative Diversity* to UNESCO and the United Nations. This 300-page policy-oriented report explores the "two-way relationship between culture and development." Development, more than just economic growth, is defined as "a process that enhances the effective freedom of people involved to pursue whatever they have reason to value." (1995: 14) Culture is defined as "ways of living together." (14)

The Commission sees culture as more than just an instrument of economic growth, but also as a desirable end in itself. The report notes that the growing economic importance of cultural industries has created a tension between commercial interests and the desire for content that reflects diversity. The

report urges a rethinking of cultural policies, suggesting that governments take a less direct, more facilitating role both in promoting cultural products and also in correcting some of the distorting effects of free market mechanisms. (41) Central to the report is its International Agenda for Culture and Development. A theme that is woven throughout its recommendations is the need for national governments and actors and international agencies and bodies to work together to promote cultural diversity.

In 1998, as a follow-up to *Our Creative Diversity*, UNESCO published the first World Culture Report, *Culture, Creativity and Markets,* as part of the UNESCO World Report Series. This interdisciplinary collection of the work of economists, social scientists, anthropologists and other specialists provides a broad range of hard data on the subject of culture and development viewed within the wider context of globalization. The analysis throughout the report demonstrates that culture is not only concerned with artistic creation and ethnic and indigenous issues, but also has social and political dimensions. (1998: 345)

Of particular interest to the discussion of issues related to trade and culture is Part 3 of the report, *Creativity, Markets and Cultural Policies*. The research outlined in this section of the report raises questions about how societies can best manage the impacts of globalization on local and national cultures and their creativity in order to sustain, preserve and protect them, and examines ways that cultural policy can be reconceptualized and reformulated to meet these changing demands. (154) The report cautions against counterproductive, inward-looking and defensive responses to global economic change and favours positive approaches that look at new opportunities to harness change and manage it. (156) It deals with several key aspects of cultural policy: the impact of global markets on creativity, on the emergence and development of cultural industries, and on cultural heritage; and protection of the rights of creators and the public interest in the age of cyber-culture. The research also suggests that many cultures and cultural products are stimulated

by intercultural contact and global markets rather than being threatened by them. (156)

The report calls for a recasting of cultural policies so that the positive impact of globalization on creativity, its opening up of markets, can be identified and encouraged; and calls for recognition of the positive and negative impacts of global markets on cultural industries "so that policy can protect and enhance their cultural and economic flowering." (345) Although it argues that diversity contributes to creativity, the report acknowledges that it is not enough simply to advocate diversity in the abstract. *Our Creative Diversity* "sets the scene, but our task now is to go beyond this and show precisely how diversity enhances economic success, social opportunity, political stability and conflict resolution, besides being valuable, beautiful and delightful in itself." (343)

Canada has been working very actively with other countries to promote the idea of cultural diversity in a number of international forums, at both the ministerial and officials level. International discussions have been particularly active in the last two years, during which a series of meetings have been organized by international organizations such as UNESCO, the World Bank and the Council of Europe to provide the opportunity for country representatives to share views and experiences on how best to protect and promote cultural diversity.

For example, in February 1998, a roundtable colloquium, Canada and the Council of Europe: A New Partnership, was hosted by the Canada-Europe Parliamentary Association. As noted by the roundtable participants in the ensuing report, increasing economic integration brings with it interpenetration of languages and cultures. The challenge of preserving social cohesion while coping with economic change has become a global phenomenon. "For advanced liberal-democracies in Europe, as in Canada, the challenge arising from these globalizing forces is to take advantage of the economic, social and cultural benefits that new technology and open markets

offer, while minimizing or eliminating the clear dangers they also present." (1998: 6)

As governments have been compelled to deal with a wide range of economic exigencies, citizens have felt the effects of government cutbacks across the broad spectrum of social policy areas including education, health, social services and housing. (8) Because culture mirrors a society's history and identity, it is essential for the development and expression of its values as well as for developing trade, employment and tourism. This is why governments have traditionally taken important measures (legislation, policy and programs) to support culture. Pressures from international trade agreements to liberalize trade and investment have also strengthened some governments' will to promote protect and preserve all aspects of cultural life in their countries, partly in response to the pervasiveness of American popular culture, and as a result of difficulties encountered when trying to preserve the ability to protect culture when negotiating new trade and investment agreements. (7)

As one conference presenter, Canadian author John Ralston Saul, put it, "Stop thinking and acting as though globalization were inevitable; adopting a passive attitude leads to accepting its repercussions. If human beings are intelligent enough to create new technology, why are they not intelligent enough to direct it instead of being directed by it? It is unacceptable that the fate of social programs, education and culture should be determined on such economic grounds." (30) Saul urges that culture and education not become "discretionary commodities." They are fundamental to society and should not be treated in simplistic market-exchange terms like a good or a service. (30-32)

Taking as a point of departure the 1995 report *Our Creative Diversity*, UNESCO held the Intergovernmental Conference on Cultural Policies for Development in Stockholm, Sweden, in March-April 1998. As a result of its discussions, the Stockholm conference adopted an Action Plan on Cultural Policies for Development, which reaffirms the fundamental principles of the

1982 Mexico City Declaration on Cultural Policies, stressing "that in its widest sense, culture may now be said to be the whole complex of distinctive spiritual, material, intellectual and emotional features that characterize a society or social group." (1998: 1) By definition, culture "includes not only the arts and letters, but also modes of life, the fundamental rights of the human being, value systems, traditions and beliefs". (1) The action plan also stresses the cultural dimension of development and the need to recognize the importance of universal values as well as cultural diversity. It highlights the growing importance of civil society in the field of culture and the importance of ensuring scope for the flourishing of creative capacities. Recognizing the rapid pace of social, technological and cultural change and the growing disparities at the national and international level, the plan underlines the importance of respecting intellectual property rights in view of the risks and challenges arising from the promotion of cultural industries and trade in cultural products.

In June 1998, on the heels of the Stockholm meeting, the Minister of Canadian Heritage hosted a conference in Ottawa dealing with international cultural policy and the importance of sustaining local and national cultures in an increasingly globalized world. The discussions focussed on three major themes: cultural diversity and development, the role of culture in global relations, and culture and trade. This last theme further examined a key conclusion from the Stockholm conference, namely that cultural goods and services should be fully recognized and treated as being not like other forms of merchandise. (1999: 14-17) Discussion also focussed on how best to build bridges between cultural and economic interests and develop strategies for the private and public sectors, and for non-governmental and international organizations. The conference resulted in the launching of an International Network on Cultural Policy, currently composed of ministers from 38 countries, whose purpose is to build increased awareness and support for cultural diversity in an era of globalization and technological change. The network continues

to work toward this aim at both the ministerial and officials levels through a series of formal and informal meetings and workshops.

Canada continues to take a leadership role in promoting cultural diversity internationally. The discussions in Stockholm and Ottawa have been accompanied by meetings in Paris, Rio de Janeiro, Washington, Rome and Oaxaca. There have also been joint declarations with the governments of Mexico and France in support of cultural diversity. The Department of Foreign Affairs and International Trade and the Department of Canadian Heritage continue to work with stakeholders at home and with governments and international organizations abroad to promote and apply Canada's vision of cultural diversity.

New Strategies for Canadian Culture and Trade

The Cultural Industries Sectoral Advisory Group on International Trade (SAGIT) is part of the federal government's advisory system on international trade. It provides a means for officials from the Department of Foreign Affairs and International Trade and the Department of Canadian Heritage to consult with representatives of Canada's cultural industries. In February 1999, the SAGIT released a position paper, *New Strategies for Culture and Trade: Canadian Culture in a Global World,* which expresses concern over the effect that global trade, combined with rapid technological change, is having on our ability to promote Canadian culture. The report outlines a number of pressures for change that are creating both challenges and opportunities for Canada's cultural industries:

1) Digitization and the convergence of the broadcasting, cable, satellite and telecommunications sectors are creating new technologies, which will compete with existing distribution systems. At the same time, there will be even greater opportunity to distribute Canadian content both at home and abroad.

2) Emerging technologies are offering Canadians new communications tools but are also challenging the government's ability to enforce regulations designed to ensure that Canadians have access to Canadian cultural products. (Note: throughout the paper "cultural products" refers to both goods and services.)
3) With the growth of multinational corporations and the vertical integration of entertainment, distribution and delivery systems and products, national policies are shifting and adapting to address these changes.
4) The trend to more open markets and a free trading world makes it more challenging to negotiate trade agreements that recognize cultural diversity and the unique nature of cultural products. (1999: ii)

The report describes the cultural policies now in place in Canada, cultural policies used by other countries, and the growing pressure from technology and international trade agreements. It then sets out options for Canada's cultural trade policy. The SAGIT proposes that Canada reaffirm the importance of cultural diversity and the desirability of ensuring that a country's own stories and experiences are available both to its citizens and to the rest of the world. In the SAGIT's view, there are two main approaches:

1) the cultural exemption strategy used in the past, which takes culture "off the table" in international trade negotiations; and
2) a new strategy involving the negotiation of a new international instrument that would specifically address cultural diversity and acknowledge the legitimate role of domestic cultural policies in ensuring cultural diversity. (ii)

According to the SAGIT's analysis, there is growing concern worldwide about the impact that international trade and investment agreements are having on culture and a recognition that the tools and approaches used in the past to keep cultural goods and services from being subjected to the same treatment as other goods and services may no longer be enough, that the cultural exemption approach has its limits. Outlining a number

of trade challenges to Canadian cultural policies that have taken place recently, the SAGIT report points out that, as countries develop freer trade, disciplines may become stricter and the number of challenges to domestic cultural policies could increase. (26) These challenges highlight the need to foster an environment where cultural expression and diversity can thrive. The report proposes that Canada call on other countries to develop a new international cultural instrument that would acknowledge the importance of cultural diversity and address the cultural policies designed to promote and protect that diversity. This new international instrument would:

- recognize the importance of cultural diversity;
- acknowledge that cultural goods and services are significantly different from other products;
- acknowledge that domestic measures and policies intended to ensure access to a variety of indigenous cultural products are significantly different from other policies;
- set out rules on the kind of domestic regulatory and other measures that countries can and cannot use to enhance cultural and linguistic diversity; and
- establish how trade disciplines would apply or not apply to cultural measures that meet the agreed upon rules. (32)

Recently, in a speech delivered to a symposium held at New York University, entitled "The World Trading System and Culture: Looking at the Problem from a Cultural Perspective," Ivan Bernier offered a further elaboration of what an international instrument on cultural diversity might contain. He noted that attempts to resolve the tension between trade and culture have been limited to subtracting goods and services from the application of trade agreements by various means. These approaches have not succeeded because they do not deal with the broader problem of cultural diversity and because they look at the problem exclusively from a trade perspective. (3) On the other hand, Bernier feels the approach proposed by the

SAGIT could succeed because it would bridge cultural and trade concerns.

To understand more concretely how the instrument would operate, he feels it is necessary to look at the principles that underlie the concept of cultural diversity, principles already expressed in a number of international agreements, resolutions and declarations. (4) Briefly stated, in order of importance these four principles are that:

1) culture is of crucial importance as a means of individual and social communication and development;
2) cultural patrimony is a crucial component of the identity and self-understanding of a people and for that reason must be protected;
3) authors have a right to the protection of their moral and material interest as regards their creations; and
4) cultural exchanges are fundamental for the promotion of understanding between peoples and for the dissemination of culture for the well-being of humanity and the progress of civilization. (4-7)

Bernier notes that a comparison of the cultural approach above with the trade approach, as instruments of development, reveals a reversal in the order of priorities. He sees this difference in perspective as at the heart of the culture/trade debate. (8) He briefly discusses the difficulty of deciding with which international organization to house the instrument – UNESCO or the WTO – and whether it would be better not to house it with any organization at all. (9) Bernier also points to the need to develop a consensus on this issue at the international level, a process in which he feels the International Network on Cultural Policy will play a crucial role. (9)

Following the release of the SAGIT report, in the 1999 Speech from the Throne, the Government of Canada announced its intention to develop a new approach internationally to support the diversity of cultural expression. In its Response to the Report of the Standing Committee on Foreign Affairs and International Trade, *Canada and the Future of the WTO,* June 1999, the government indicated that it will try to build support

for this strategy with domestic stakeholders and in such forums as the International Network on Cultural Policy, UNESCO, the WTO, the OECD and La Francophonie and, pending developments with respect to the negotiation of a new agreement, will continue to seek the maximum flexibility in international agreements to pursue its cultural policy objectives.

Concluding Remarks

As the preceding literature review indicates, although opinion on the subject of trade and culture is divided, certain key messages can be clearly delineated. Trade is not an end in itself, but the means to a broader objective – a better society. The significance of cultural works is also social and political as well as economic. The pursuit of national cultural objectives is just as important as foreign and trade policy objectives. Cultural goods and services are *not* like other forms of merchandise. Cultural diversity is preferable to homogeneity. Governments have an important role to play in promoting and preserving cultural diversity.

Although economic integration is a global phenomenon, having an impact on cultures around the world, in the Canadian context the debate is really about Canada and the impact on Canada of our largest trading partner and closest neighbour, the United States. Given this geographical proximity, a common language shared by the majority of their citizens, common historical roots, and common influences on legal and political traditions and economic development, it is not surprising that the influence of American culture on Canadian culture, particularly English-Canadian culture, is overwhelming. A number of different theoretical models underlying cultural development policy and programs have been outlined in the articles reviewed. Many authors perceive the efforts of the United States in forcing the model they favour, the market-driven model, on other nations through trade agreements as a threat to global cultural diversity.

At the heart of the debate are the cultural industries, which act both as instruments for the communication of Canadian culture and as the bond that holds Canadians together – not just in the narrow sense of the arts, but in the larger meaning of our pastimes, habits, images, institutions, perspectives on the world and collective memory. Since the coming into force of the Free Trade Agreement in 1989, the effectiveness of the cultural exemption has been the focus of a great deal of discussion. Although views differ considerably, there appears to be a consensus that the exemption is not working. A number of different alternatives have been outlined in the literature, but nearly all are based on a common premise: a rules-based system is preferable to one where the uncertainty created by continued legal challenges and retaliation is weakening, bit by bit, the viability of Canadian cultural policy.

There also seems to be a growing opinion that content and investment rules aimed at ensuring space for "Canadian voices telling Canadian stories" are not accomplishing their intended objectives. A number of commentators have suggested how this might be remedied, with general agreement among them that more emphasis needs to be placed on ensuring truly "Canadian" content. Some authors have also described how technological changes occurring in Canada's cultural industries are hastening the development of new media, namely interactive video, audio and text-based services rooted in the convergence of telecommunications, computing and broadcasting. These changes are challenging traditional economic and regulatory models for the cultural industries and underline the need to rethink them.

For any new approach to succeed, it will also be important for those nations that sign on to clearly accept the basic principles that underlie it. Getting agreement on these principles, particularly from our largest trading partner, will be one of our greatest challenges. In this context, as several authors have indicated, it is important to understand that the position of the United States is also founded on basic principles and a history of government support for cultural endeavours. It will

also be important to continue to strengthen the emerging international consensus on the need for a cultural diversity instrument.

Trade liberalization has a direct economic impact on Canada's cultural industries and by extension on Canadian culture, but what impact does the consumption of massive amounts of foreign cultural products and services have on Canadian identity? Current research cannot answer this question definitively. Research does indicate that Canadians have cultural values and attitudes that are different from those of Americans, but it also indicates that these differences are growing less and less as they converge toward a common set of North American values. This is not Americanization, but part of a hemispherical and global phenomenon. Values and attitudes change very slowly, over generations. Although free trade has probably acted as a catalyst in this process, it is clearly not the only catalyst for change. What is unclear is where, ultimately, this convergence of values will lead us, and whether, at the end of the day, it will determine our ability to remain distinctly Canadian. It is still too early to tell.

Finally, a growing number of observers in Canada and abroad are expressing concern that the integration of economies around the world is leading to increasing pressures being placed on the "social contracts" that hold our societies together. There seems to be little doubt that economic integration is having an impact on social cohesion; however, this does not have to represent economic determinism. The nation-state is not irrelevant. It still has an important role to play in ensuring that the negative impacts of economic integration are mitigated and that its benefits are shared by all members of society.

A number of the researchers whose works have been reviewed in this paper have identified gaps in our knowledge of the relationship between economic integration and culture. In this context, it is worth noting that as part of the Trends Project a number of research teams are currently undertaking research of direct relevance to trade liberalization and culture, identity and social cohesion. Their research will address such questions

as: What effect does globalization have on the shaping of identity? On social systems? On the common institutions within which people live and work? On the maintenance and development of social cohesion? What is different about North American integration today, and what does this mean for things Canadians care about? What is likely to happen to North American integration in the next decade? What can be done to preserve and enhance the opportunities and minimize the risks from North American integration? The results of this research are expected to be available sometime in the year 2000.

References

1. Acheson, Keith, and Christopher Maule. *Much Ado about Culture: North American Trade Disputes,* Studies in International Economics, 1999.

2. Adams, Michael. *Sex in the Snow: Canadian Social Values at the End of the Millennium*, 1997.

3. Alesina, Alberto, Enrico Spolare and Romain Wacziary. *Economic Integration and Political Disintegration*, National Bureau of Economic Research, Working Paper 6163, 1997.

4. Banting, Keith. "What's a Country For? Globalization, North American Integration and Social Policy," Address to the Industry Canada Distinguished Speakers in Economics Program, January 2000.

5. Bernier, Ivan. "Cultural Goods and Services in International Trade Law," in *The Culture/Trade Quandary: Canada's Policy Options*, edited by Dennis Browne, 1998.

6. Bernier, Ivan. "The World Trading System and Culture: Looking at the Problem from a Cultural Perspective," Speech delivered at New York University, January 2000.

7. Browne, Dennis, editor. *The Culture/Trade Quandary: Canada's Policy Options*, 1998.

8. *Canada and the Council of Europe: A New Partnership*, Report on the Roundtable Colloquium hosted by the Canada-Europe Parliamentary Association, Ottawa, February 1998, Parliamentary Research Branch, June 1998.

9. *Canada and the Future of the WTO*, Response to the Report of the Standing Committee on Foreign Affairs and International Trade, June 1999.

10. Carr, Graham. "Trade Liberalization and the Political Economy of Culture: An International Perspective," in *Canadian-American Public Policy,* No. 6, June 1991.

11. Collins, Richard. "Trading in Culture: The Role of Language in Cultural Development in an Open Economy," *Canadian Journal of Communication*, Vol. 19, 3/4, 1994.

12. Friedman, Thomas L. *The Lexis and the Olive Tree*, 1999.

13. Garten, Jeffrey E. "Cultural Imperialism Is No Joke," *Business Week*, November 1998.

14. Goldfarb, Rebecca. *The Implications for the Cultural Sector of Harmonization of Economic Policies and Standards*, SRA Report, Canadian Heritage, 1998.

15. Goodenough, Oliver J. "Defending the Imaginary to Death? Free Trade, National Identity, and Canada's Cultural Preoccupation," *Arizona Journal of International and Comparative Law*, Vol. 15, No. 1, 1998.

16. Inglehart, Ronald F., Neil Nevitte and Miguel Basanez. *The North American Trajectory: Cultural, Economic, and Political Ties Among the United States, Canada, and Mexico,* 1996.

17. Jeffrey, Liss. "The Impact of Globalization and Technological Change on Culture and National Identity: A Call for Visionary Pragmatism," in *The Culture/Trade Quandary: Canada's Policy Options*, edited by Dennis Browne, 1998.

18. Jeffrey, Liss. "Rethinking Audiences for Cultural Industries: Implications for Canadian Research," *Canadian Journal of Communication,* Vol. 19, 3/4, 1994.

19. Lipset, Seymour Martin. *Continental Divide: Values and Institutions of the United States and Canada*, 1991.

20. Lorimer, Rowland, and Nancy Duxbury. "Of Culture, the Economy, Cultural Production, and Cultural Producers: An Overview," *Canadian Journal of Communication*, Vol. 19, 3/4, 1994.

21. McFadyen, Stuart, Adam Finn, Colin Hoskins and Rowland Lorimer, editors. "Introduction," *Canadian Journal of Communication,* Vol. 19, 3/4, 1994.

22. *New Strategies for Culture and Trade: Canadian Culture in a Global World,* Cultural Industries Sectoral Advisory Group on International Trade (SAGIT), February 1999.

23. *Putting Culture on the World Stage*, Final Report of the International Meeting on Cultural Policy, Ottawa, Canada, Canadian Heritage, 1999.

24. Rabinovitch, Victor. "Social and Economic Rationales for Domestic Cultural Policies," in *The Culture/Trade Quandary: Canada's Policy Options*, edited by Dennis Browne, 1998.

25. Raboy, Marc, Ivan Bernier, Florian Sauvageau and Dave Atkinson. "Cultural Development and the Open Economy: A Democratic Issue and a Challenge to Public Policy," *Canadian Journal of Communication,* Vol. 19, 3/4, 1994.

26. Ramonet, Ignacio. *Geopolitics of Chaos* (translated from the French by Andrea Lyn Sacara), 1998.

27. Rodrik, Dani. "Five Simple Principles for World Trade," Op-ed, November 1999.

28. Rodrik, Dani. *Has Globalization Gone Too Far?* 1997.

29. Schwanen, Daniel. *A Matter of Choice: Toward a More Creative Canadian Policy on Culture*, C.D. Howe Institute Commentary, 1997.

30. Scott, Sheridan. "The Impact of Technological Change on Canada's Cultural Industries," in *The Culture/Trade Quandary: Canada's Policy Options*, edited by Dennis Browne, 1998.

31. *Senate Committee Report on Social Cohesion*, Senate Standing Committee on Social Affairs, Science and Technology, June 1999.

32. *The State of Affairs in the Nation Today,* The Goldfarb Report 1999.

33. UNESCO. *Culture, Creativity and Markets*, The World Culture Report 1, 1998.

34. UNESCO. *Our Creative Diversity*, Report of the World Commission on Culture and Development, 1995.

35. UNESCO. *The Power of Culture*, Report of the Intergovernmental Conference on Cultural Policies for Development, Stockholm, Sweden, March-April 1998.

36. *Vital Links: Canadian Cultural Industries*, Department of Communications, 1987.

International Trade, Health Systems and Services: A Health Policy Perspective

Jake Vellinga
Health Canada

This paper was prepared on behalf of the PRI-GCON Working Group on World Trade Issues. The views in this paper are those of the author and do not necessarily reflect those of Health Canada.

Introduction

International trade in health services is neither new nor entirely unfamiliar. For example, Canada trades in health services every time a Canadian "snowbird" obtains medical care in Florida. There is international trade whenever local nurses or doctors go abroad to work, or foreign practitioners come to Canada. Health services are traded when doctors and hospitals hook up across international borders via telecommunications systems to collaborate on the delivery of health services. And trade takes place when a Canadian health services company operates abroad, or a foreign-owned company delivers services here.

Relatively new, though, are international trade agreements that establish legal frameworks of binding rules for trade in services, including health services. This is nowhere more evident than in the World Trade Organization (WTO) and its General Agreement on Trade in Services (GATS). In 1994, more than a hundred WTO members completed the Uruguay Round of trade negotiations that included the GATS.

According to the WTO Secretariat, "the Uruguay Round agreement on trade in services is perhaps the most important single development in the multilateral trading system since the GATT[1] itself came into effect in 1948."[2] The Secretariat further explained that the GATS "extends to all forms of international trade in services" and "...because such a large share of trade in services takes place *inside* national economies, that its requirements will from the beginning necessarily influence national domestic laws and regulations in a way that has been true of the GATT only in recent years."

All services, including health services, are covered by the GATS services classification. GATS provisions require WTO members to progressively liberalize trade in services over time. In other words, there will be successive rounds of negotiations, beginning in 2000, to reduce or eliminate trade barriers and discriminatory trading practices worldwide.[3]

This paper explores some of the links between international trade and health services from a health policy point of view. Trade in health services can have far-reaching consequences for the health sector and health, and can create conflict between trade/economic goals and health/social objectives. It is, therefore, important for the health policy and research communities, as well as the trade policy community, to identify and address the key issues raised by trade in health services.

The potential dollar value of international trade in health services is enormous. The paper begins, therefore, with a brief look at the extent of health spending globally and in

---

[1] General Agreement on Tariffs and Trade; this covers trade in goods (e.g. health goods would include medical devices and equipment, pharmaceuticals).

[2] World Trade Organization Secretariat, *Guide to the Uruguay Round Agreements* (The Hague: Kluwer Law International, 1999), 161.

[3] Note: the launch of negotiations on services in 2000 was mandated in the Uruguay Round agreement itself, as part of the "built-in agenda," and was not dependent on a new round getting underway.

industrialized countries. An examination of the role of the public and private health sectors, particularly in the financing of health care, but also in the delivery of these services, makes clear that this sector is not just another form of commercial activity. A framework is suggested for considering the interrelationships between international trade and health. The core issue is the significance of international trade for achieving health objectives. How trade impacts on health involves both trade in goods (health and non-health goods) and trade in services. But the relationship goes much further. International trade can influence key determinants of health as well.

A more detailed examination of international trade in health services occupies the rest of the paper. According to the GATS, trade in services takes place in four modes: when services cross borders, when consumers go abroad, or by the mobility of capital and labour. These modes of trade in services are looked at in terms of their possible meaning for health services; the broader implications for health systems and health objectives are also considered.

The Health Sector

Spending on health

The sheer size of global annual expenditures on health care goods and services – about US$3 trillion[4] – is suggestive of the potential economic impact of trade liberalization. To put this in some context, world trade in all goods and services was US$6.7 trillion in 1998. Trade in services was US$1.3 trillion,

[4] G. Wolvaardt, "Opportunities and Challenges for Developing Countries in the Health Sector," in S. Zarrilli and C. Kinnon (eds.), *International Trade in Health Services: A Development Perspective* (Geneva: United Nations, WHO, 1998), 63-70.

or about 20 percent of that total.[5] In the United States, the world's leading exporter, health services are among the top 10 services exports (health services exports totalled US$921 million in 1997.[6]

According to the Organization for Economic Co-operation and Development (OECD),[7] health care services are one of the largest industries in its member countries. Although health expenditures as a percentage of gross domestic product have stabilized in recent years, OECD countries spent, on average, 8.1 percent of GDP on health in 1997. The GDP share was highest for the U.S. at 13.9 percent, and lowest for Turkey at 4.9 percent. Canada spent 9.2 percent of GDP on health, while the European Union and Japan spent 8.0 percent and 7.2 percent respectively.

Payers and providers

The public sector is, by far, the largest financier of health services among OECD countries. From 1970 to 1990, public sector health spending within the OECD grew to 74.2 percent of total health spending as governments undertook to make health services more accessible to their populations. There was then a period of decline in the public sector share of health spending as governments tackled continuously escalating health costs. By 1997, OECD member governments were financing, on average,

---

[5] World Trade Organization, "WTO Services and Agriculture Negotiations: Meetings Set for February and March" (Press Release, February 7, 2000).

[6] U.S. Department of Commerce, International Trade Administration, "Top Ten Services Exports, 1997" (http://www.ita.doc.gov/sif/topten.htm).

[7] OECD, Employment, Labour and Social Affairs Committee, Working Party on Social Policy, *Trends in Health Expenditure 1970-1997* (DEELSA/ELSA/WP1(99)17, September 30, 1999).

73.7 percent of total health spending in their countries. In the European Union, 76.6 percent of all health spending was publicly financed, while the U.S. and Korea with a public share of 46.4 percent and 45.5 percent respectively were clear outliers among OECD countries.[8]

In Canada, total health expenditures (goods and services) for 1999 were approximately $86 billion.[9] This represents 9.2 percent of Canada's GDP, a share that has been relatively stable since 1995, even though the annual rate of growth in total health expenditures has accelerated (from an annual rate of growth of 1.4 percent in 1995 to 5.1 percent in 1999). The public sector remains the predominant source of health financing in Canada, accounting for approximately 70 percent of all health spending in 1999, although this is down from approximately 75 percent in 1991. Health spending is a major component of provincial governments' budgets, being roughly one quarter to a third or more of total budgetary spending depending upon the province.

According to the Canadian Institute for Health Information, private health spending in Canada consists mainly of out-of-pocket outlays by households and spending by private health insurance firms for supplementary or additional health benefits not covered or only partially covered by governments (e.g. primarily dental and drug services, but also the services of various health providers).

In 1999, about 62 percent of Canada's total health spending was accounted for by three categories: hospital services (32.5 percent), drugs (15.2 percent) and physician services (13.9 percent). Given Canada's universal, publicly financed

---

[8] The U.S., other than for its Medicaid and Medicare programs for the poor and elderly, relies primarily upon private sector financing and market forces in its health system.

[9] Based on a forecast by the Canadian Institute for Health Information, *National Health Expenditure Trends: 1975-1999* (Ottawa: 1999).

system for necessary hospital and physician services, it is not surprising that almost 92 percent of total spending on hospital services and 99 percent of all spending on physician services are paid for publicly. Public health services (e.g. public health nursing and health promotion) are 100 percent publicly financed, and 57 percent of health research is financed publicly.

Private financing is the dominant source of funds for dental services (94 percent); vision care (90 percent); prescription drugs (59 percent); non-prescribed drugs (100 percent); and services of other health professionals such as chiropractors, physiotherapists, psychologists, private duty nurses and naturopaths (69 percent).

Public financing does not necessarily mean public delivery of health services. Among OECD countries, most health systems fall into one of the following categories:[10]

- mainly private providers with a mix of public and private financing;
- mixed public and private providers with mainly public financing; or
- mainly public providers and mainly public financing.

Canada's health care system is generally described as being largely publicly financed and privately delivered. This, however, oversimplifies the relationship between public and private health sectors in financing and delivering health services. The accompanying table, adapted from the National Forum on Health's examination of Canada's health system in the mid-1990s, illustrates more fully the interface between the two sectors.[11]

---

[10] OECD, *The Reform of Health Care: A Comparative Analysis of Seven OECD Countries,* Health Policy Studies No. 2 (Paris: OECD, 1992), 13.

[11] National Forum on Health, *The Public and Private Financing of Canada's Health System* (Ottawa: 1995).

Table 1: Financing and Delivery of Canada's Health Services

Service type	Financing	Delivery
Hospital services	100 percent public for medically necessary services; private for non-medically required hospital services or upgraded accommodation	Mixed public/private. Varies by province. Generally strong government regulation of sector
Physician services	100 percent public for medically necessary services (no extra billing allowed); private payment for non-medically necessary services	Private physicians are independent and self-regulating: some models of primary care delivery are more akin to government agencies (e.g. CLSCs in Quebec)
Services in private clinics	Privately funded if service is not medically necessary; some clinics charge patients a facility fee for medically necessary services over and above the funding provided by the provincial health insurance plan	Privately owned and operated – limited regulation
Dental/ optometry care	Mostly private (insurance or out-of-pocket); some provincial plans provide coverage for children and seniors	Private and self-regulating – i.e. dentists and optometrists
Prescription drugs	Mixed public/private; provincial plans pay for approximately 40 percent of all prescription drugs dispensed outside hospitals. Coverage is typically limited to seniors and welfare recipients. Drugs dispensed in hospitals are covered in hospital budgets. Balance is funded by a combination of private insurance plans and out-of-pocket	Private – delivery includes prescription by physician and dispensing by pharmacist or hospital

Non-prescription drugs	Mostly private (out-of-pocket)	Private – over-the-counter
Services of other professionals	Mostly private (insurance or out-of-pocket) – with limited coverage by provincial plans	Private (e.g. psychologists, physiotherapists, chiropractors, midwives, private duty nurses)
Alternative medicines	Mostly private (insurance or out-of-pocket)	Private – e.g. naturopaths, homeopaths, practitioners of oriental medicine, traditional Aboriginal healers
Long-term care (residential)	Mixed public/private; public portion covers insured health care services; private portion covers room and board	Mixed public/private
Home care	Partial public coverage provided in most jurisdictions; informal caregivers play an important role	Mixed public/private
Ambulance services	Partial public coverage in some provinces; special programs for residents of remote areas	Mostly private operators
Public health programs	Public	Public
Services to status Indians and Inuit	Public	Mixed public/private (federal government employees deliver some services directly)

The nature of health care: public good or private commodity?

Commercial trade in health services has enormous economic potential. Yet actual trade volumes are relatively low,

liberalization is little in evidence, and governments remain significant players in the sector. Why that is the case needs to be investigated and understood.

For Drache and Sullivan,[12] the defining or core issue concerning public and private health is whether health care is a commodity or public good. Is it a public good that states should provide, or a commodity like any other that should be subject to market rules and disciplines – and, one would add, subject to trade and its liberalization?

There is overwhelming evidence that health care is *not* a normal market commodity; and health care markets are *not* ideal.[13] [14] [15] [16] [17] No major developed country treats health care like just another market commodity, or distributes it through normal market mechanisms.[18] [19] Chief among the reasons are:

---

[12] D. Drache and T. Sullivan (eds.), "Health Reform and Market Talk: Rhetoric and Reality," in *Market Limits in Health Reform: Public Success, Private Failure* (London: Routledge, 1999), 1-21, p. 5.

[13] J. White, *Competing Solutions: American Health Care Proposals and International Experience* (Washington, D.C.: The Brookings Institution, 1995).

[14] OECD, *The Reform of Health Care: A Comparative Analysis of Seven OECD Countries,* op. cit.

[15] OECD, *Health Care Reform: The Will to Change.* Health Policy Studies No. 8 (Paris: OECD, 1996).

[16] World Trade Organization, Council for Trade in Services, "Health and Social Services: Background Note by the Secretariat," S/C/W/50 (Geneva: World Trade Organization, September 18, 1998).

[17] National Forum on Health, *The Public and Private Financing of Canada's Health System,* op. cit.

[18] Ibid.

[19] J. White, *Competing Solutions: American Health Care Proposals and International Experience,* op. cit.

- the fact that health care is based on needs, not wants; and access to care should not be based on ability to pay;
- the unpredictability of need for health care and the relatively high burden of payment in the absence of insurance, as well as incentives for private insurers to avoid high-risk patients or limit insured coverage for costly care; and
- the asymmetry of knowledge and information that favours care providers (physicians) and requires patients to rely upon their advice and approval for care.

The World Health Report 1999 has this to say on the issue:[20]

> Market mechanisms have enormous utility in many sectors and have underpinned rapid economic growth for over a century in Europe and elsewhere. But the very countries that have relied heavily on market mechanisms to achieve the high incomes they enjoy today are the same countries that rely most heavily on governments to finance their health services. Therein lies a lesson. Health is an important component of national welfare. Achieving high health outcomes requires a combination of universal entitlement and tight control over expenditure.

Evans[21] points to the fact that all industrialized countries but the United States have opted for universal public payment systems to provide their principal health services. Broadly speaking, these systems share such features as more or less universal insured coverage, comprehensive coverage of principal benefits, income-based contributions, administrative mechanisms to control costs, and a primary role for the state in

---

[20] World Health Organization, *The World Health Report 1999: Making a Difference* (Geneva, 1999), 33.

[21] R. Evans, "Health Reform: What Business Is It of Business?" in D. Drache and T. Sullivan (eds.), *Market Limits in Health Reform: Public Success, Private Failure* (London: Routledge, 1999), 25-47.

financing and/or regulating for purposes related to, for example, cost control or equity of access.

Not even the widespread reform of European health systems over the 1980s and 1990s to seek greater efficiency, effectiveness and patient choice and influence altered the primary role of the state in ensuring access to health services. In their analysis of these reforms, Saltman and Figueras[22] conclude that western European countries maintained their commitment to universal access and sustainable financing and did not shift from publicly to privately accountable funding.

Tuohy[23] observes that even in the climate of fiscal pressures in the last two decades, publicly financed health systems in OECD countries did not reduce eligibility for insured coverage as a possible response to these pressures. In fact, during this period, two countries, the United States and the Netherlands, attempted to increase the role of the state in health care and expand publicly insured coverage for their citizens. Neither initiative succeeded, a fact Tuohy ascribes to the difficulty of expanding public programs in the fiscal climate of the 1990s.

International Trade in a Health Policy Framework

In a health policy framework, the core international trade issue concerns the consequences of trade for achieving health objectives, such as those set out for health systems by the World Health Organization:[24]

---

[22] R.B. Saltman and J. Figueras, "Analyzing the Evidence on European Health Care Reforms," *Health Affairs* (March/April 1998): 85-108.

[23] C.H. Tuohy, *Accidental Logics: The Dynamics of Change in the Health Care Arena in the United States, Britain and Canada* (New York: Oxford University Press, 1999).

[24] World Health Organization, *The World Health Report 1999: Making a Difference,* op. cit., 32-33.

- improving health status;
- reducing health inequalities;
- enhancing responsiveness to legitimate expectations;
- increasing efficiency;
- protecting individuals, families and communities from financial loss; and
- enhancing fairness in the financing and delivery of health care.

There are a number of ways that international trade can impact on health systems and health objectives.[25] Trade in goods is one way. Such trade may be in health goods (e.g. pharmaceuticals, medical devices, equipment) that consumers buy directly or that health systems use in the provision of care, or it may be in the form of non-health goods (e.g. hazardous wastes and materials, unsafe industrial technologies,[26] tobacco) that can affect health.

Pharmaceuticals provide an example. Some trade agreements provide for international enforcement of patent protection. This is the case in both the North American Free Trade Agreement (NAFTA) and the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). While the importance and benefits of intellectual property protection in terms of stimulating innovation are widely recognized, patent protection provisions are raising issues concerning the production of needed drugs, drug prices, access to necessary medications and health system costs.[27] [28]

---

[25] D.W. Bettcher, D. Yach and G. E. Guindon, "Global Trade and Health: Key Linkages and Future Challenges," *Bulletin of the World Health Organization* (2000), 78 (4): 521-534.

[26] D.B. Menkes, "Exporting Hazards to Developing Countries," *World Health Forum* (Vol. 19, 1998): 412-416.

[27] C.M. Kinnon, "World Trade: Bringing Health into the Picture," *World Health Forum* (Vol. 19, 1998): 397-405.

Access to medicines in developing countries is one concern. For example, in response to criticism of U.S. trade policy to enforce drug patents of U.S. pharmaceutical companies, President Clinton announced a new policy at the 1999 Seattle WTO Ministerial meeting to ensure access to medicines for the world's poorest people. The United States Trade Representative and Health and Human Services have implemented a co-operative approach on health-related intellectual property issues to address cases where U.S. trade law related to intellectual property significantly impedes a foreign government's ability to deal with a health crisis.[29] This resulted in an Executive Order of May 10, 2000, to allow sub-Saharan African countries to provide residents with better access to HIV/AIDS drugs and medical technologies to combat AIDS.[30]

Food products and their safety are another example. Sanitary and phytosanitary measures in trade agreements are there to, among other things, protect human health from unsafe food. No one doubts the importance of ensuring the safety of food in the global trade environment. There is, however, a growing issue of whether the WTO's Agreement on Sanitary and Phytosanitary Measures favours commercial trade over health interests. High-profile and controversial WTO dispute challenges concerning growth hormones in beef and British beef (the "mad cow disease" issue) have fuelled debate over trade protectionism, the precautionary principle and how countries assess and manage risks to protect health in the international trading system.

---

[28] "Sleep Less in Seattle," *The Lancet* (Vol. 354, December 4, 1999): 1917.

[29] USTR, "USTR Releases Super 301, Special 301 and Title VII Reports" (Press Release, May 1, 2000).

[30] The White House, "Executive Order: Access to HIV/AIDS Pharmaceuticals and Medical Technologies" (Press Release, May 10, 2000).

A second major way that international trade can impact on health is through trade in health services. This trade may be in services directly related to the provision of health services, such as trade in hospital, physician and nursing services, or it may be trade in affiliated services in the health sector, such as health insurance, health facility management, or educational services in the health field. It is the links between this kind of trade and health that this paper will focus on in the next section.

A third way that trade can impact on health is through the relationship between trade, the economic outcomes it may produce (e.g. growth and development, productivity gains, improved prosperity, higher standards of living, and job creation) and the broader determinants of health. To the extent that international trade improves such outcomes, there is the possibility, according to a determinants-of-health approach, for population health to benefit.[31] For instance, trade that creates jobs has the potential to improve health because of a positive relationship between employment and health.

But, by itself, trade's impact on broader health determinants is no guarantee that desirable health outcomes will follow. Sound health policies on access and equity to health services are a necessary condition. For example, Amartya Sen,[32] the Nobel Prize winning economist, reminds readers that it would be a mistake to take as the main lesson that economic prosperity is related to good health. The link is there: economic prosperity and good health are positively related. But the relationship is more complex. The "finer points" of the relationship, as Sen notes, suggest that good health, in the form of longevity, is more likely to materialize when economic prosperity works through poverty removal and public health care. For Sen, it is

---

[31] R. Evans, M. Barer and T. Marmor, *Why Are Some People Healthy and Others Not?* (New York: Aldine de Gruyer, 1994).

[32] A. Sen, "Economics and Health," *The Lancet* (Vol. 354, December 1999): siv. 20.

how the fruits of economic growth are used – particularly in the form of a commitment to public health care – that matters most for better health outcomes.

A similar, broader point was made in the *Human Development Report 1999* regarding the relationship between trade, growth and human development.[33] In looking at countries such as Egypt, Pakistan, Russia, the Republic of Korea, Botswana, Chile, Malaysia and Thailand, the report concluded that a strong link between trade and growth is no guarantee of a strong link with human development and well-being. Trade and growth need to be accompanied by a comprehensive package that, depending upon the country situation, includes economic, social and governance reforms, in order to improve welfare.

International Trade in Health Services and the GATS

With the GATS of 1994, a multilateral discipline with basic rules for liberalizing trade in all services was established. As a legal framework, the GATS aims to reduce or eliminate measures that prevent or discriminate against the provision of services across borders, or against foreign-owned services or foreign service providers in the market of another economy. This agreement has been called a "landmark" for creating multilateral disciplines in the "virgin" territory of services and, up to now, a "failure" in establishing freer trade in services.[34] Proponents of trade liberalization are counting on this changing when WTO members negotiate "progressive liberalization" of services as required in the agreement. A new round of GATS

---

[33] United Nations Development Programme, *Human Development Report 1999* (New York: Oxford University Press, 1999).

[34] B. Hoekman, "Assessing the General Agreement on Trade in Services," in W. Martin and L.A. Winters (eds.), *The Uruguay Round and the Developing Countries* (New York: Cambridge University Press, 1995), 327-364.

negotiations, begun in February 2000, will test how far WTO members are prepared to liberalize trade in services in general, and trade in health services in particular.

GATS covers all services except those "supplied in the exercise of governmental authority," which it defines as services that are neither delivered on a commercial basis nor in competition with other service suppliers (GATS Article I (3)(b)(c)). The WTO Council for Trade in Services appears to suggest that this Article would apply only in the case of a rather pure form of governmental supply of health services – that is, direct, free-of-charge government provision of medical and hospital treatment without private sector involvement.[35] Despite the Council's attempt at clarity, the meaning of this Article and its application to publicly financed health services with mixed public/private delivery is far from clear. An examination of this element in the GATS, however, is beyond the intent of this paper. Clearly though, this "exemption" has major significance for the health sector and WTO members' strategic approaches in current and future GATS negotiations.

Under the GATS, services are delivered through one or more of the following modes:

- mode 1: cross-border – the service, not the supplier, crosses national borders;
- mode 2: consumption abroad – the consumer crosses national borders to receive a service;
- mode 3: commercial presence in the consuming country – a foreign-owned facility supplies the service in the territory of another country; and
- mode 4: temporary movement of natural persons – foreign service suppliers cross national borders to provide the service.

Trade liberalization of services entails specific GATS commitments being made by a WTO member, in one or more of

---

[35] WTO Council for Trade in Services, "Health and Social Services: Background Note by the Secretariat," op. cit.

these modes of supplying services, to allow access to its domestic market (market access), and/or to treat foreign companies and/or providers on the same footing as domestic companies/providers (national treatment). There is a general obligation in the GATS for WTO members to accord most favoured nation treatment (MFN) to all other WTO members unless a specific exemption on MFN has been taken.

How do the GATS modes of service delivery apply to health services? What are possible implications, in terms of potential opportunities and costs, if health services are liberalized in these modes? What are some typical barriers to trade in the four modes of services? On what modes of service supply have countries liberalized their trade in health services? These and other questions are explored in the next sections.

Mode 1: cross-border trade in health services

In this GATS mode of service supply, the service itself moves across national borders (movement of services). Telehealth and telemedicine[36] are the most cited examples of cross-border services trade in the health field. These technology- and knowledge-based health services are playing a larger role in the health field as governments worldwide search for solutions to such issues as health care cost containment, access to needed health care, the quality of care, waiting lists, the supply and distribution of health human resources and public expectations

[36] As used by Industry Canada (Strategis website), the terms telehealth and telemedicine are defined as follows: telehealth: the use of information and communications technologies to deliver health and health care services and information over large and small distances; telemedicine: all forms of remote medicine – teleconsultations, telepathology, teleradiology, telepsychiatry, teledermatology, telecardiology, etc. In Europe, telehealth is called health care telematics.

of health care systems. An overview of some telehealth applications appears in Tables 2 and 3.[37]

Table 2: Telehealth Categories and Users

Category	Users
All forms of medicine-at-a-distance: teleconsultations, telepathology, teleradiology, telepsychiatry, teledermatology, telecardiology, etc.	Physicians, health care professionals, health care institutions
Inter-institutional, patient and clinical records and information systems, electronic health and clinical records and databases accessible by network	Health care institutions, professionals and workers, physicians' offices, researchers
Public Health and Community Health Information Networks (CHINs) and multiple-use health information networks	Government (including policy makers), epidemiologists, public health professionals, physicians' offices, pharmacies, clinics and CHINs
Tele-education and multimedia applications for health professionals and patients, and networked research databases; Internet services	Universities and colleges, associations, researchers, physicians, health care professionals, patients
Telemonitoring, telecare networks, telephone triage, remote home care, and emergency networks	Consumers, elderly, chronically ill, disaster and accident victims, telenurses, call centre users or operators

[37] Industry Canada Strategis website, "Sector Competitiveness Framework Series: Telehealth Industry, Key Points about This Industry" (1998).

Table 3: Telehealth Applications that Can Facilitate Health Care Procedures

Health care procedures, process	Possible telehealth application
Telephone-based or face-to-face consultation between specialists and general practitioners	Videoconferencing, IATV, computer-based e-mail
Physical transfer of medical images for specialist opinion on radiographs, ultrasound, computed tomography scans, pathology slides	Electronic transfer of images to specialists; comparison of images against banks of stored electronic slides and images for comparison
Handwritten, paper-based patient files and charts	Palm-top pen-based computer tablets, desktop workstations, computerized patient records
Handwritten, paper-based prescriptions	Electronic prescription ordering using a CHIN, HIN or pharmanet
Consulting Compendium of Pharmaceuticals and Specialties, 32nd ed. (Ottawa: Canadian Pharmacists Association, 1977) for information on drug being prescribed	Drug interaction software, drug information database online
Home visits unassisted by technology	Laptop or portable computer with modem to communicate with physician or health care institution
Home care, elder care	Telemonitoring from the home, assisted devices and technologies
Visits to the emergency room of the local hospital	Telecare, teleassisted triage, 1-900 telephone calls to obtain assistance, video visits
Referrals from general practitioner	Appointments by e-mail, electronic scheduling by general practitioners
Patient travelling from remote location if requiring specialized counselling, diagnosis or treatment	Video-consultation with specialist from afar
Literature search in medical library for current literature on new	Electronic search from home or office using Medline or other

procedures, clinical trials, etc.	medical information management and database retrieval service
Travel to another location for grand rounds, continuing medical education, conferences, meetings, seminars	Attendance from home or office via audio, video or computer conferencing, or interactive TV
Clinical trials	Clinical trial management systems, expert advice online

Expectations are that the worldwide growth in telehealth/telemedicine services will be considerable. For example, the potential demand for several such services in 2000 was projected to be as follows:[38] [39]

- telemedicine services in their various forms at about US$1.1 billion;
- direct patient care telehealth services at about US$800 billion;
- continuing professional education at about US$3.9 billion; and
- online health information, which now occupies about 10 percent of total Internet content, at about US$21 billion.

The implementation and use of telehealth/telemedicine services, even *within* national health systems, raise such issues as the recognition of credentials and licensure; legal liability and malpractice considerations, including provider insurance coverage; provider remuneration; patient privacy and confidentiality; the existence of enabling infrastructure and compatibility of standards in such areas as data, images and

[38] Feedback Research Services, January 1996, quoted in Industry Canada Strategis website, Ibid., p. 100.

[39] Industry Canada, "Life Sciences Branch – Health Industries: Canadian International Business Strategy (CIBS) 1999-2000: Health Services, 2000," Strategis website (http://strategis.ic.gc.ca/SSG/ht01195e.html).

medical records; infrastructure and future operating costs; the extent of demand for such care and the cost implications; and the quality and appropriateness of care.

Some indication of Canadians' changing relationship with the health system, particularly as it concerns health information, comes from a recent survey that found the Internet to be the principal information source on health for 8 percent of Canadians.[40] This figure jumps to almost 28 percent for those without a family physician. Of those relying on the Internet for health information, one third did so for self-diagnosis, while one third used it to check a diagnosis from their doctor. A majority of respondents favoured being able to ask doctors questions electronically, making appointments online and being referred to specialists via e-mail. Using the Internet for drug prescription refills was supported by about 40 percent, while 33 percent thought online annual check-ups were a good idea.

In his look at the Internet in the United States, Goldsmith makes the point that use of this new technology has the potential to significantly change the interaction between consumers and the health system.[41] Using the Internet for health information is a prime reason why people log on: 70 million Americans sought health information on the Internet in 1999. He points out that it is not unusual now for individuals to access health and medical information and data that previously were only available to health and medical providers. Goldsmith regards the resistance of the medical profession to adopting Internet technology, and privacy and confidentiality issues as the two major hurdles facing the spread of the Internet's use for health services.

---

[40] A. Picard, "Media Main Source of Medical Data: Poll, Health Information Comes from All Sources," *The Globe and Mail* (July 5, 2000).

[41] J. Goldsmith, "How Will the Internet Change Our Health System?" *Health Affairs* (January/February 2000, Vol. 19, No. 1): 148-156.

In the United States, a concern with protecting consumers against illegally dispensed drugs may lead to new laws to regulate the sale of prescription drugs over the Internet. More than 200 websites are being investigated for possibly selling unapproved drugs or approved medications without valid prescriptions.[42]

A recent U.S. study on the privacy policies of 21 health information websites found that these sites held unprecedented amounts of personal health information supplied by site visitors. The problem, however, is that the personal health information is shared without the knowledge or consent of the person who provided this information – information available to third-party networks allowed them to construct detailed, personally identified profiles of individuals' state of health. According to the study's authors, the privacy policies of the various websites fell short of giving adequate privacy and confidentiality protection.[43]

In the United States, a report by the National Research Council on Internet use in health care cited the need for new policies to regulate the protection of electronic records containing health information and to address the reimbursement of doctors. The report also noted that state licensure practices are currently a barrier to interstate provision of telemedicine services.[44]

---

[42] Bureau of National Affairs, "FDA Warns Foreign Online Drug Sites that Sales to United States May Be Illegal," *Health Care Policy Report* (Vol. 8, No. 6, Feb. 7, 2000): 210.

[43] Bureau of National Affairs, "Health Information Web Sites Do Not Protect Consumer Privacy, Study Finds," *Health Care Policy Report* (Vol. 8, No. 6, Feb. 7, 2000): 234.

[44] Bureau of National Affairs, "Stimulating Internet Use in Health Care Requires New Technology, Policy, Report Says," *Health Care Policy Report* (Vol. 8, No. 9, Feb. 28, 2000): 342.

As well, a concern with the quality of Internet health care has led the Internet Healthcare Coalition to draft a code of ethics on business practices for Internet health care. The draft code will cover such areas as privacy, commerce, content and services, disclosure, and the practice of health care on the Internet. The Coalition also plans to conduct a global review of the draft code via online public hearings and consultations.[45] Finally, a U.S. survey of Internet sites of state medical boards used to post information about physicians disciplined by the boards found that most of the online information varied considerably, was difficult to access and inadequate to inform and protect consumers.[46]

International trade in telehealth and telemedicine services makes the complexity of issues such as these even greater, and their resolution more difficult. Some recent developments may be illustrative of the complications that can arise when health care services cross borders.

Canadian doctors who give advice or care to U.S. citizens via the Internet or telehealth may face significant risks if sued. The Canadian Medical Protective Association (CMPA) has informed doctors of its new policy not to cover and defend them in the case of a lawsuit in the United States arising from care provided to Americans in Canada.[47] The CMPA will continue to defend doctors in lawsuits by U.S. citizens in Canadian courts. One physician, commenting on this new CMPA policy, stated that issues around telehealth are "in flux" and still being debated

---

[45] Bureau of National Affairs, "International Group Works Toward Ethics Code for Health Care Web Sites," *Health Care Policy Report* (Vol. 8, No. 6, Feb. 7, 2000): 231.

[46] Bureau of National Affairs, "State Medical Boards' Online Data on Disciplined Doctors Inadequate, Study Finds," *Health Care Policy Report* (Vol. 8, No. 6, Feb. 7, 2000): 235.

[47] J. Manzer, "Treating Americans: A Subsidy for Our Health Care?" *The Medical Post* (May 2, 200): 5.

(e.g. whether the treating doctor needs a licence in the patient's home location).

And the U.S. Food and Drug Administration has warned several foreign websites that their Internet sales of prescription drugs may be illegal. The possibility of an international strategy to combat illegal sales of pharmaceuticals also is being explored.[48]

Adams and Kinnon[49] of the World Health Organization Task Force on Health Economics assessed the possible implications for developing countries of trade liberalization in health services across the GATS modes of supply for three health objectives: equitable access to health services, quality of health services and efficiency of resource allocation. These authors concluded that, with so little trade in telemedicine currently taking place or known, there is no evidence one way or the other that health objectives will be advanced with trade liberalization. In this regard, the issue is not so much what such trade can or cannot do, but whether governments can harness it to improve equity of access, the quality of care or the efficiency of its delivery.

Mode 2: consumption abroad

In this form of service supply, it is the consumer who receives a service in another country by going abroad (movement of the consumer). Health services to tourists, and students going abroad for their health and medical education, are typically cited as examples in the health sector. The United Nations Conference on Trade and Development (UNCTAD) considers

---

[48] Bureau of National Affairs, "FDA Warns Foreign Online Drug Sites that Sales to United States May Be Illegal," *Health Care Policy Report* (Vol. 8, No. 6, Feb. 7, 2000): 210.

[49] O. Adams and C. Kinnon, *Health Economics Technical Briefing Note: Measuring Trade Liberalization against Public Health Objectives: The Case of Health Services* (Geneva: World Health Organization, 1997).

health services consumption abroad as the dominant mode of service supply – that is, most transactions in international trade in health services involve the movement of consumers for health care and education in the health/medical fields.[50]

Why UNCTAD, for example, counts health/medical education and training as part of the supply of a health service, rather than the supply of educational services, is not clear. The distinction between health services and educational services in the WTO services classification is clear. Health services are generally services intended to promote, maintain and restore physical, mental and social health and well-being. When students go abroad for health/medical education/training services, that is trade in educational services, not health services.

Another definitional issue concerns the circumstances under which the receipt of a health service abroad constitutes trade. Do all health services delivered to non-residents in another country qualify as trade? Are there criteria for determining when it is trade and when it is not trade? Is it, for example, a matter of who receives the services (i.e. non-residents and how that term is defined), who pays for the service (e.g. the patient, the patient's private health insurance, the patient's home country, the host country), or the health circumstances under which the service is delivered? Regarding the latter, one can distinguish two broad health circumstances: elective or non-emergency care and non-elective or care required on an urgent basis. A question then arises whether care delivered abroad to a non-resident (e.g. a tourist) on an urgent basis constitutes trade.

Very little is known about trade in health services, with neither data nor information readily available to answer questions such as the following: Other than under health emergencies, why do individuals seek health services abroad?

---

[50] UNCTAD, *Preparing for Future Multilateral Trade Negotiations: Issues and Research Needs from a Development Perspective* (New York and Geneva: 1999).

What kind of health services do they seek and in what countries? Are they more or less likely to seek health services abroad if they have public versus private health insurance at home? How much of this care is paid for out-of-pocket versus by public health or private health insurance plans? What impact does the provision of health services to non-residents have on the health system of the supplier country, and on access and quality of care for residents of that country?

Among the reasons that individuals may seek care abroad are:[51]

- Such care is not available at home (e.g. care is sought in regions that offer special treatments or possess special facilities such as hot springs or spas).
- Such care is not insured at home.
- Care elsewhere is of higher quality or available from more prestigious facilities and providers, or of equal quality but lower cost.
- Obtaining care abroad is consequential to decisions to retire or spend part of the year in warmer climates.

A major barrier to the movement of consumers is the lack of portability of health coverage, either by public or private health insurers, across national borders. An exception would be private health insurance specifically for travellers to cover or help cover the costs of out-of-country emergency health care. For some developing countries, consumption abroad in the form of "health tourism" is seen as an important future source of trade, if a solution to the non-portability of benefits can be found.[52]

---

[51] UNCTAD Secretariat, "International Trade in Health Services: Difficulties and Opportunities for Developing Countries," in S. Zarrilli and C. Kinnon, *International Trade in Health Services: A Development Perspective* (Geneva: United Nations, WHO, 1998), 3-34.

[52] D.D. Benavides, *Trade Policies, Export of Health Services in a Development Perspective*, Preliminary draft, Inter-regional Meeting on Health and Trade: Towards the Millennium Round, November 3-5, 1999, Washington, D.C.

According to the Industry, Trade and Technology Review in the United States, a global medical insurance plan was introduced in 1998 by the International Health Alliance that would allow one to travel anywhere in the world to receive medical care.[53]

In Canada, portability of insured coverage is one of five principles of the Canada Health Act (CHA), the federal health legislation governing federal government financial assistance to provincial governments' health care systems. The CHA's portability provisions include out-of-country portability for medically necessary hospital and physician services. This out-of-country portability is limited, however, to covering medically required services at payment rates in one's province of residence. Additionally, provincial health insurance plans can require prior approval for elective out-of-province care without contravening the Act. This latter feature allows health plans to control against individuals seeking care out-of-country when it is available at home, and serves as an important health system cost containment mechanism.

Rules governing the European Union also provide for the portability of medical benefits across member countries if the health care is required in an emergency.[54] Prior approval is needed for elective care in another EU country before the care will be paid for by the patient's home country. This condition governing elective care in another EU country, and its payment by the patient's home country, has been successfully challenged in court in what have become known as the Kohll and Decker cases. In both cases, the European Court of Justice ruled that reimbursement provisions were inconsistent with the EU's requirements for the free movement of goods and services, and

---

[53] D.R. Luther, "Health Care Services: Strong Fundamentals and Innovations Foreshadow Growth in U.S. Exports and Foreign Direct Investment," *Industry, Trade and Technology Review, Health Care Services* (June 1999): 19-25.

[54] V. Kendall, *The Prospects for Private Healthcare in Europe* (London: The Economist Intelligence Unit, June 1999).

that the rules of member states' social security systems had to comply with these free movement provisions.

These court rulings also may have broader implications for the extent to which EU members' social security systems, including health systems, remain the sole responsibility of member states, and outside the application of EU rules. For instance, in the Netherlands there is a concern that national law provisions requiring "solidarity contributions" by privately insured patients toward coverage for others under public health insurance may contravene EU rules on fair competition.[55] Similar concerns exist regarding the use of national and regional agreements on prices to control the cost and type of care, and certain rules set out in obligatory contracts between hospitals and insurers that may be seen as forming cartels and obstructing foreign competition.

In the absence of widespread portability of health benefits, one's financial capacity and willingness to pay for travel and treatment costs become determining factors in consumption abroad. In the United States, the treatment of foreign patients is the largest component of that country's exports in health services.[56] From 1992 to 1996, these exports grew at an average annual rate of 5 percent. The slower rate of growth of 2 percent in 1997 is attributed to currency devaluations that made travel and treatment costs more expensive for patients from Asia, Latin America and Canada.

A study by Anderson et al.[57] raises questions about the willingness of patients to pay more in order to obtain more

---

[55] T. Sheldon, "EU Law Makes Netherlands Reconsider Its Health System," *British Medical Journal* (Vol. 320, January 22, 2000): 206.

[56] D.R. Luther, "Health Care Services: Strong Fundamentals and Innovations Foreshadow Growth in U.S. Exports and Foreign Direct Investment," op. cit., 20.

[57] G. Anderson et al., "Willingness to Pay to Shorten Waiting Time for Cataract Surgery," *Health Affairs* (September/October, Vol. 16, No. 5, 1997): 181-190.

timely access to care. A survey of patients in Manitoba, Canada; Barcelona, Spain; and Denmark on waiting lists for cataract surgery found limited support for paying higher taxes or out-of-pocket for more timely treatment in their home countries. What is interesting for trade considerations is: if patients *on waiting lists* are generally unwilling to pay more for faster treatment at home, how willing are patients in general to pay for care abroad, and what factors are significant in their decisions to seek such care?

As noted earlier, currency fluctuations can deter foreign patients from seeking care in the United States. Can currency changes, along with lower relative treatment costs and quality health care, induce patients from the U.S. and elsewhere to seek care in Canada? An absence of data prevents systematic analysis of this question, but some examples are illustrative. A private facility in Toronto that performs hernia surgery reports that about 20 percent of its 7,000 annual operations are on American patients.[58] In British Columbia, a favourable Canadian exchange rate, lower treatment costs and good quality of care for laser eye surgery help to attract foreign patients, especially from the U.S. and Asia. One physician reports that 40 percent of his patients come from abroad; another notes that, in some months, more than half of his patients are from the United States.[59] One Canadian laser eye surgery clinic estimates that, each month, 40 percent to 50 percent of its clients at 15 clinics across Canada come from the United States.[60] This company has also expanded into the U.S. market partly in

---

[58] C. Leslie, "The Private Clinic Debate," *The Medical Post* (May 9, 2000): 22-23.

[59] H. Kent, "Huge Declines in Price as Competition Heats Up in Vancouver's Booming Laser-Surgery Market," *Canadian Medical Association Journal* (Oct. 5, 1999), 161 (7): 857-858.

[60] L. Landon, "The Lure of the Laser: Cheap, Safe Eye Surgery Draws Americans to Canada," *The Ottawa Citizen* (July 11, 2000).

response to the possibility of fewer future American customers as the U.S. eye surgery business grows. Another laser eye surgery clinic, this one in British Columbia, advertises its services in Seattle and has a clientele that is about 90 percent American.[61]

Another example, albeit for a health good rather than a service, is that of U.S. seniors, described in the media as "drug price refugees," busing to Canada to buy necessary medications at significantly lower cost.[62] The State of Vermont is examining the possibility of more formal arrangements with the Province of Quebec to facilitate access to medications from that province for Vermont residents. In a similar vein, U.S. Senate candidate and wife of U.S. President Clinton, Hillary Clinton, is reportedly proposing legislation to enable access for U.S. citizens to lower-cost prescription drugs sold in Canada.[63]

One of the barriers facing Canadian doctors when considering to treat American patients, and presumably patients from other countries as well, is the Canadian Medical Protective Association's policy of not defending doctors in lawsuits in American courts brought forward by American patients who have been treated in Canada.[64] Even precautions by a doctor to have U.S. patients sign a consent form/contract agreeing to the treatment and restricting any legal action to Canada and Canadian laws may not suffice to protect doctors if they advertised services to attract foreign patients. An expert in

---

[61] C. Leslie, "The Private Clinic Debate," op. cit.

[62] I. Peritz, "U.S. Seniors Shopping in Canada for Drug Prescriptions Too Costly in States, Protester Says," *The Globe and Mail* (January 20, 2000).

[63] A. Nagourney, "Mrs. Clinton Favors American Access to Cheaper Canadian Medicines," *The New York Times* (February 9, 2000).

[64] J. Manzer, "Treating Americans: A Subsidy for Our Health Care?" op. cit. As noted earlier, this policy bears importantly on the decision to provide services through telemedicine.

medical law, however, believes that doctors can protect themselves with service contracts that state clearly that the contract proceeds under Canadian law, and that any legal action and damages will be based on Canadian law. The same expert cautions doctors to ensure that their advertising to foreign patients is also clear on these matters.

What is known about Canada as an export source of patients for the U.S. health services market? In his article on U.S. health services exports, Luther[65] notes that there are no official data on exports of health services by country, but industry representatives he interviewed believe that Canada is the dominant export market, while other key markets include the United Kingdom, Germany, Mexico, Australia and Japan.

In one of the rare studies on Canadians' use of the U.S. health system, Katz, Verrilli and Barer found no support for the perception, popularized by critics of Canada's public health care system, that Canadians are frequent users of U.S. health services.[66] Data from Ontario's health insurance plan were analysed. It was found that Ontario spent US$1.1 billion on U.S. medical services between 1987 and 1995, but this represented less than 1 percent of the health insurance plan's total medical payments. Moreover, changes during the study period in Ontario's reimbursement policies for out-of-country health services resulted in dramatic declines in the amount of spending for these services from the levels that prevailed in 1987-1991, when the province's benefits were comparatively generous. There is evidence, according to the authors, that the United States is a destination for care when that care is not as readily available in Canada. An important shortcoming of the

---

[65] D.R. Luther, "Health Care Services: Strong Fundamentals and Innovations Foreshadow Growth in U.S. Exports and Foreign Direct Investment," op. cit.

[66] S.J. Katz, D. Verrilli, M.L. Barer, "Canadians' Use of U.S. Medical Services," *Health Affairs* (January/February, 1998): 225-235.

study, noted by the authors, is the omission of private health financing (i.e. spending for care in the United States via out-of-pocket payments and private health insurance).

The Canadian Institute for Health Information (CIHI) and Statistics Canada consider cross-border shopping by Canadians for health care to be too rare for reliable measurement in existing national surveys.[67] In the National Population Health Survey, 1998/99, fewer than 0.1 percent of respondents said they had been treated in the United States in the past year. CIHI data also show that 3,200 Americans were treated (mostly for hernia surgery) at acute care hospitals in several Canadian provinces.

At various times, some Canadian provinces have made temporary arrangements with nearby facilities in the United States to meet pressing health care needs beyond the capacity of local resources. For example:[68]

- At one time the British Columbia Cancer Agency sent patients to the United States for radiation treatment. The Agency is now considering sending 600 patients to U.S. facilities for such treatment.
- Ontario will spend $23.1 million for radiation treatment in the U.S. for 700 cancer patients.
- Quebec is sending several hundred cancer patients to U.S. facilities for treatment.

The need for such arrangements has been attributed to a shortage of radiation therapists, medical physicists and larger numbers of cancer patients in an ageing population.[69] Interestingly, even though this out-of-country care is paid for by

---

[67] Canadian Institute for Health Information, Statistics Canada, *Health Care in Canada: A First Annual Report* (Ottawa, 2000), 13.

[68] "Guarding the Border: The U.S. Role in Canadian Care," *The Medical Post* (January 4, 2000): 1-2.

[69] L. Priest, "Want Health Care in Canada? Sign This Waiver," *The Globe and Mail* (January 8, 2000).

the provincial health insurance plans, the same article reports that about half of patients referred abroad for treatment refuse to go abroad. Thus, the decision to seek care abroad is only partly explained by coverage and portability factors. Other factors of likely significance for the willingness to go abroad for care include the medical condition, urgency of treatment, duration of treatment, and proximity of treatment to home and family.

To summarize, while our understanding of individuals' decision making to seek care abroad is limited, the mix of factors goes beyond the portability of insured benefits and what trade negotiations can address. Economic considerations (e.g. ability to pay, currency fluctuations, the cost of care), personal factors (e.g. willingness to pay, willingness to go abroad), the nature of the health condition and need for care (e.g. elective vs. emergency care), and aspects related to the care itself (e.g. its quality, proximity of the treatment facility, duration of the treatment) and liability related to malpractice would all appear to play roles.

Finally and most importantly for health policy, a key issue is the implications that consumption abroad has for such objectives as equitable access to health care. As Adams and Kinnon[70] note, the major concern is that equity of access for local residents will suffer from a policy of exporting health services to foreign patients. In treating foreign patients, access to care becomes largely based on ability to pay for care, not one's need for care, which leads to preferred access for foreign, paying patients. There is a further concern about using or redirecting scarce financial, human and capital resources to serve the needs of foreign rather than local patients. The situation is more complex than this suggests, however, and an analysis of the risks needs to consider several aspects, including:

---

[70] O. Adams and C. Kinnon, *Health Economics Technical Briefing Note: Measuring Trade Liberalization against Public Health Objectives: The Case of Health Services,* op. cit.

- the mode of financing of the health system – public or private;
- the extent of insured coverage by the health system – universal or selective;
- the particular health services being promoted for consumption abroad, taking into account how these are financed by the health system and whether they fall inside or outside the basket of insured services;
- the capacity of the health system to provide care to foreign patients – whether there is excess capacity or the system is already stretched to its limits;
- the health needs of the population versus those of foreign patients (e.g. basic health needs vs. highly specialized needs);
- whether the facilities and providers treating foreign patients are inside or outside a publicly or privately financed health system; and
- whether the revenues generated from treating foreign patients go to the public or private sector, and what use is made of these revenues (e.g. whether they go to improve the health system or other determinants of health such as education or employment).

Mode 3: commercial presence

In mode 3, services are supplied by a foreign service supplier who has established a commercial presence in the country (the movement of capital). The service supplier may also bring in some foreign providers or managers – combining mode 3 with mode 4 – but the tendency is to use local service providers.

The WTO Secretariat states that commercial presence is "the most important mode of supply of services, at least in terms of future development," and that it "also raises the most difficult

issues for host governments and for GATS negotiations."[71] That is because many services, for instance a medical treatment, generally require the service provider and recipient to be in the same place. Efforts and rules to liberalize trade via commercial presence, therefore, target the reduction or elimination of measures that restrict market access to foreign suppliers, or treat these suppliers differently from domestic ones. In other words, this form of trade directly challenges governments' domestic policies and measures.

UNCTAD[72] notes four categories of commercial presence in the health sector:

- in the hospital operation/management sector;
- in the health insurance sector;
- in the health/medical education sector; and
- in ad hoc arrangements (e.g. temporary presence in a developing country as part of a health development funding project).

UNCTAD also points out that there are many restrictions, or outright prohibitions, in most countries on foreign commercial presence in the health sector. Chief among them are economic and needs-based quantitative limitations; rules favouring local over foreign suppliers; restrictions on property acquisition; foreign investment restrictions; and prohibition of for-profit hospitals or foreign ownership of hospitals or other health facilities.

The United States is a prime example of both sides of the commercial presence coin. On the one hand, U.S. health care companies are major exporters of services via their foreign

---

[71] WTO Secretariat, *Guide to Uruguay Round Agreements*, op. cit., 164.

[72] UNCTAD Secretariat, "International Trade in Health Services: Difficulties and Opportunities for Developing Countries," op. cit., 19.

affiliates. Luther's[73] examination of health sector fundamentals in the United States found that American foreign affiliates averaged annual growth in sales of 25 percent between 1992 and 1995, but that sales plunged by 47 percent, or US$360 million, in 1996. This is attributed to several of the U.S. health care service providers refocussing their core business activities back in the U.S. domestic market (in two instances related to U.S. Department of Justice investigations of company practices). As an aside, the withdrawal of foreign suppliers from health sectors in other countries raises questions about the impact that such withdrawal may have on the host health system (e.g. in terms of its ability to meet health care needs).

There is also significant commercial presence of foreign affiliates in the U.S. health care market. In each year from 1992 to 1996, the United States purchased more health services from U.S.-based foreign affiliates than it sold abroad through the foreign affiliates of U.S. health services providers. In 1996, health services sales by foreign affiliates in the United States increased 126 percent to US$3.5 billion as a result of a couple of major acquisitions of U.S. health services companies. The foreign presence in the U.S. health services market was dominated in 1996 by companies based in Germany, Canada, Australia and Japan, in that order. In comparison, more than half of all health services sales by U.S. affiliates abroad were in the United Kingdom. Luther attributes the greater openness of the U.S. market to private provision of health services as being conducive to the establishment of foreign affiliates. U.S. firms, on the other hand, are hampered by the fact that many foreign governments control their health systems, or restrict the

[73] D.R. Luther, "Health Care Services: Strong Fundamentals and Innovations Foreshadow Growth in U.S. Exports and Foreign Direct Investment," op. cit., 21.

financing of private health sector services. Luther concludes, however, that the outlook for U.S. commercial presence abroad will likely improve as foreign governments allow a greater role for the private sector in their health care systems.

Managed care is a prominent U.S. health export. This is not surprising since most managed care companies are for-profit and, as their domestic markets shrink, they look abroad to maintain their economic bottom lines. The Economist Intelligence Unit[74] notes that there may not always be a good fit between the managed care approach and health systems in other countries, but there still remain merits in this approach for some other countries' financing, administration and delivery of health care. Managed care was seen as less exportable in countries with relatively low health spending, a shortage of specialists, weak data collection and management systems, and where employers are not a part of the health care process. Two examples given of international activity in the managed care field are BlueCross/BlueShield of Delaware in Taiwan and UnitedHealthcare Global Consulting in South Africa.

Industry predictions that managed care would make significant inroads in European health systems have not materialized. One spokesperson attributed this to the strength of lobbies (and of doctors in particular), technical difficulties related to implementation, and a debate that confused ideological (state vs. market) and technical (e.g. efficiency) issues. Other reasons cited were opposition to managed care, government regulation and the special status of health care in European countries.[75] Prime examples of this failure were attempts at "prescription by mail" (mail order pharmacies) and

---

[74] The Economist Intelligence Unit, "Profile – Is US-Style Managed Care Exportable?" *Healthcare International* (London: EIU, 1st Quarter, 1999): 46-56.

[75] The Economist Intelligence Unit, "Profile – An Uphill Struggle for Managed Care in Europe," *Healthcare Europe* (London: EIU, 3rd Quarter, 1999): 29-40.

disease management plans. Export efforts by U.S. companies into Europe continue, and the strategy appears to have shifted from one of transplanting the U.S. model to one of focussing on selective elements of managed care that hold more promise of acceptance.

Latin American countries (e.g. Argentina, Brazil, Chile, Mexico, Peru, Colombia, Ecuador, Guatemala, Panama, Venezuela, Uruguay) are also an export destination for U.S. and European managed care firms. According to Stocker et al.,[76] several factors are contributing to this: economic circumstances favourable for managed care (e.g. strong economic growth, small percentage of GDP spent on health, low private health insurance coverage); the presence of foreign multinational (principally American) companies that favour managed care plans for their employees; and loan conditions set by, for example, the World Bank and other lending bodies that favour privatization and less public spending. With the presence of managed care companies in Latin America, there is a growing concern that access to health care is suffering (e.g. co-payments to patients), and that resources that could be spent on health services are going toward administration costs and returns to investors.

The diffusion of managed care abroad is raising concerns about the impact on health services and health because of growing evidence of managed care's negative impacts in the United States. Faced with a profitability squeeze and increased competition, the U.S. managed care industry has pursued policies of cost containment, market consolidation and acquisitions. One major consequence of this market-driven

---

[76] K. Stocker et al., "The Exportation of Managed Care to Latin America," *The New England Journal of Medicine* (April 8, 1999): 1131-1136.

health care, according to Kuttner,[77] is restrictions on services and care. He sums up his look at the industry this way:

> In the early 1990s, entrepreneurs succeeded in obtaining the easily available cost savings, at great profit to themselves and their investors. By the late 1990s, however, pressure to protect profit margins had led to such dubious business strategies as the avoidance of sick patients, the excessive micromanagement of physicians, the worsening of staff-to-patient ratios, and the outright denial of care. In an industry driven by investor-owned companies, the original promise of managed care – a greater efficiency in the use of available resources and greater integration of preventive and treatment services – has often degenerated into mere avoidance of cost. (p. 668)

[77] R. Kuttner, "The American Health Care System: Wall Street and Health Care," *The New England Journal of Medicine* (February 25, 1999): 664-668.

A backlash by patients and providers has developed in response to the industry's actions. Several states have attempted to protect patients through patients' rights legislation. In October 1999, the U.S. House of Representatives passed a bill to protect patients in managed care plans by making it easier for them to see a specialist, to obtain prescription medicines and care in hospital emergency rooms, and to sue health care providers for injuries suffered from being denied care.[78] California, Georgia and Texas now have legislation that allows patients to sue health plan providers for harm resulting from the denial of care.

Foreign commercial presence in the health sector is about privatization, albeit privatization with a difference – whether to allow foreign companies to finance and/or deliver health care services. Privatization in the health sector of a country is a necessary but not sufficient condition for foreign commercial presence (i.e. a country may allow privatization but prohibit foreign companies from its health sector). In the case of health systems, however, the fundamental issue is privatization, and not so much whether privatization is by domestic or foreign companies. That is not to deny the importance of issues concerning domestic versus foreign privatization ventures (e.g. different approaches to privatization by domestic and foreign companies).

[78] J. Rovner, "US Government Strengthens Patients' Rights," *The Lancet* (Vol. 354, October 16, 1999): 1366.

As a mode of health services supply and trade liberalization, foreign commercial presence fits squarely in the debate about public/private health care in health policy. Not surprisingly, arguments for both privatization and foreign commercial presence are similar (e.g. better cost control, improved efficiency and quality of care and services). The evidence, however, generally does not support these arguments. The case of managed care has already been mentioned. In their study of Australia's hospital sector, White and Collyer[79] found that, with the growth of foreign and local corporate investment, "the capacity of the state to plan, coordinate, and manage the health care sector is being steadily eroded, as is the capacity of the profession to act in the interests of patients and the public at large." (p. 506) With private ownership, the goals of efficiency and profit dominated at the expense of health objectives concerning equity, access, quality of service, and public accountability. Barraclough[80] expresses similar concerns about the situation in Malaysia, which has a growing private hospital sector supported by foreign companies and the government's own investments in private hospitals.

A fuller discussion of the public/private issue is, however, beyond the scope of this paper. Technical and ideological dimensions of this debate can be found in the health policy

---

[79] K. White and F. Collyer, "Health Care Markets in Australia: Ownership of the Private Hospital Sector," *International Journal of Health Services* (Vol. 28, No. 3, 1998): 487-510.

[80] S. Barraclough, "The Growth of Corporate Private Hospitals in Malaysia: Policy Contradictions in Health System Pluralism," *International Journal of Health Services* (Vol. 27, No. 4, 1997): 643-659.

literature, including recent books by Drache and Sullivan[81] and Tuohy.[82]

The question remains, however, that if the advantages of privatization are so evident, why is it that most industrialized countries, with the notable exception of the United States, have health care systems that are predominantly publicly financed, provide universal coverage, and tend to achieve better outcomes on health status, efficiency and cost control? In their study of OECD countries, Anderson and Poullier[83] found that in the United States health spending, both in GDP and per capita terms, was higher; the rate of growth in spending was more rapid; the percentage of the population insured for health was lowest; hospital days per capita were fewest; hospital expenditures per day were highest; physician incomes were higher; and outcome measures were in the lower half of all countries in the study.

Finally, there may be some irony in the relationship among trade liberalization, free markets and economic development. Health expenditure data indicate that as countries' incomes increase, the share of total health spending by the public sector increases.[84] This is attributable to the higher revenue base of governments, as well as their choice to use public rather than private financing to address market failures in the health sector. This reinforces the point made by the WHO, cited earlier in this paper. Countries that have benefited most from market

---

[81] Drache and Sullivan, *Market Limits to Health Reform: Public Success, Private Failure,* op. cit.

[82] Tuohy, *Accidental Logics: The Dynamics of Change in the Health Care Arena in the United States, Britain and Canada,* op. cit.

[83] G.F. Anderson, J.-P. Poullier, "Health Spending, Access, and Outcomes: Trends in Industrialized Countries," *Health Affairs* (May/June 1999): 178-192.

[84] G. Schieber and A. Maeda, "Health Care Financing and Delivery in Developing Countries," *Health Affairs* (May/June 1999): 193-205.

mechanisms to achieve their higher levels of development are the same countries that rely upon government financing in the health sector to achieve such objectives as equity and access.

Mode 4: presence of natural persons

The supply of health services under the GATS mode 4 means that a foreign service supplier crosses into another country to provide services (i.e. the movement of labour). This may be in conjunction with foreign commercial presence (i.e. where the foreign establishment hires foreign service providers), or where the foreign provider is an employee of a foreign service company, or where the service provider is acting alone. A key point to note is that this GATS mode of trade liberalization is limited to the temporary movement of labour. Mobility associated with citizenship, residence and employment on a permanent basis is excluded. The GATS, however, neither defines the meaning of temporary presence nor specifies a time frame that applies to the term "temporary."[85]

According to UNCTAD, this form of trade in health services is significant because of the labour-intensive nature of health services, shortages of health human resources in many countries, and the more or less universal scientific knowledge upon which health services are based.[86] It notes that the flow of physician labour has, over time, changed from a situation where the supply came mainly from developed countries to one where

---

[85] WTO Council for Trade in Services, *Presence of Natural Persons (Mode 4)*, S/C/W/75 (Geneva: WTO, December 1998).

[86] UNCTAD Secretariat, "International Trade in Health Services: Difficulties and Opportunities for Developing Countries," op. cit., 6.

developing countries are now a significant supplier. UNCTAD reports that 56 percent of all migrating doctors come from developing countries, but only 11 percent go to these countries. The difference may be even larger for nurses.

"Rich" countries have been criticized by Kirsten Stallnecht, President of the International Council of Nurses, for using their "pseudo-shortages" of nurses to recruit nurses from developing countries.[87] According to Stallnecht, a root cause of shortages in developed countries is human resource policies that lead nurses to leave the profession. Better policies to retain nurses, for example, would solve such pseudo-shortages. Instead, developed countries are recruiting nurses from developing countries whose health care will suffer as a result of the loss of nurses.

UNCTAD also notes a significant trend of the lowest-income countries having difficulties replacing their lost health human resources. For example, South Africa has experienced a loss of doctors both to out-migration to developed countries, and to the private health sector at home. Faced with a shortage of physicians, South Africa has had to rely upon arrangements with neighbouring and more distant countries to meet needs for medical personnel. Situations like this in the developing world raise concerns about the consequences of the loss of needed health human resources on health outcomes and health systems in these countries.

More and more countries are facing health human resource shortages. For example, Japan's need for an increasing number of nurses to care for an ageing population may lead to changes in that country's visa and residency regulations to permit foreign nurses to work there.[88] This easing of policies to allow foreign

---

[87] A. Picard, "Brain Drain Hurts World Health: Expert," *The Globe and Mail* (June 21, 2000).

[88] J. Lamar, "Japan to Allow in Foreign Nurses to Care for Old People," *British Medical Journal* (Vol. 320, March 25, 2000), 825.

nurses would be a significant development in a country where foreign residents represent a relatively small percentage of the population. Norway, Sweden as well as the United Kingdom, Ireland and France are all looking to Germany's physician surplus as a possible source for doctors to meet their own supply shortages.[89] In Canada, both the Canadian Nurses Association and Canada Medical Association have raised concerns about shortages in their respective fields and the impact on the health system.

A recent Statistics Canada study[90] found that the health professions were most affected by the "brain drain" of knowledge workers to the United States. For instance, in 1996 and 1997, permanent emigration relative to the stock of workers in Canada was highest for doctors and nurses; in the 1990s there were 19 physicians and 15 nurses leaving Canada for every physician and nurse entering the country; and the annual loss of doctors and nurses has been high relative to the supply of new graduates in these professions (equivalent to about 25 percent of the number of new graduates). In contrast, a lower labour market demand for health professionals in the 1990s led to a decline of 40 percent and 70 percent, respectively, in the immigration to Canada of doctors and nurses.

According to Adams and Kinnon, the temporary movement of health human resources across national borders has potential significance for access to health care, the quality of care and efficiency of the health sector.[91] In the originating country,

---

[89] K. Birchard "Germany's Surplus of MDs the First Stop in Attempt to Fill Shortages," *The Medical Post* (May 2, 2000), 55.

[90] J. Zhao, D. Drew and T.S. Murray, "Brain Drain and Brain Gain: The Migration of Knowledge Workers from and to Canada," *Education Quarterly Review* (Statistics Canada, Catalogue no. 81-003, 2000, Vol. 6, No. 3): 8-35.

[91] O. Adams and C. Kinnon, *Health Economics Technical Briefing Note: Measuring Trade Liberalization against Public Health Objectives: The Case of Health Services,* op. cit.

emigration that results in shortages of needed health human resources can mean reduced access to care, for example, in terms of what services may be available, or the time it takes to access services. Quality of care may suffer from a loss of highly skilled and experienced providers, and efficiency will be reduced in a system that spends public funds to educate and train health human resources only to have them leave.

The opportunities and costs of labour mobility to a country's health system will depend upon a combination of factors including the health needs of the population (e.g. changing population demographics), the health human resources situation in the country (e.g. supply, demand and distribution), and policy and program reforms in the health system (e.g. shift in care from hospital- to community-based services). Also, the labour-intensive nature of health services means that labour costs are one of, if not *the,* major cost factors faced by health systems. This fact, and its links to labour inflows and outflows, is not lost on governments that fund such services and need to contain costs as part of keeping health systems sustainable.

Being the originating or recipient country of labour movements is also important for health systems, as noted earlier, but also more generally. Originating countries may risk a loss of domestic resources and transfer of educational investment, but benefit from experiences brought back by those who went abroad temporarily, and from remittances sent home by persons working abroad. For recipient countries, the temporary movement of labour can help to address labour shortages and provides access to providers at lower overall investments (e.g. training costs borne by the originating country).[92]

---

[92] WTO Council for Trade in Services, *Presence of Natural Persons,* op. cit.

Several measures can affect the cross-border movement of labour. UNCTAD[93] mentions the following:

- economic needs tests (e.g. the need/demand for the service; whether the service can be supplied locally);
- licensing, accreditation, certification, and the recognition of foreign qualifications;
- requirements on nationality and residency;
- particular subnational (i.e. provincial or state) requirements;
- immigration requirements;
- access to exams for meeting qualifications; and
- discriminatory regulation of fees and expenses.

The European Union presents one example of difficulties associated with the freer movement of labour. In the EU, employment legislation regarding mutual recognition of professional qualifications is intended to improve the labour mobility among countries, including the cross-border movement of health care workers with diplomas as medical professionals, general care nurses or in pharmacy.[94] Labour mobility, however, has been limited due to, among other reasons, bureaucratic difficulties and the need for fluency in the host country's language.

According to the WTO,[95] few members made comprehensive GATS commitments to liberalize the movement of labour under market access and national treatment. Adlung[96]

---

[93] UNCTAD Secretariat, "International Trade in Health Services: Difficulties and Opportunities for Developing Countries," op. cit.

[94] V. Kendall, *The Prospects for Private Healthcare in Europe,* op. cit.

[95] WTO Council for Trade in Services, *Presence of Natural Persons,* op. cit.

[96] R. Adlung, "Services Trade Liberalization from Developed and Developing Country Perspectives," in P. Sauvé and R.M. Stern (eds.), *GATS 2000: New Directions in Services Trade Liberalization* (Washington, D.C.: The Brookings Institution, 2000), 112-131.

attributes this to political and economic sensitivities about having foreign service providers physically present in their territories. The health sector reflects this general pattern where few WTO members liberalized services trade based on the movement of labour. In the case of professional services (physicians, dentists, midwives, nurses, physiotherapists and paramedical personnel), Butkeviciene and Diaz[97] found that the majority of scheduled commitments on market access and national treatment were "unbound" (i.e. no commitment to liberalize – the country remains free to introduce trade-restrictive measures). Nationality and permanent residency requirements, as well as requirements for permits, authorization, and registration or membership in professional associations were measures restricting the movement of professionals. This situation of limited trade liberalization also applied to hospital and other health services. The health services sector, then, saw little mode 4 trade liberalization in the first round of GATS.

Conclusion

Despite the occurrence of international trade in health services, few WTO members agreed to binding commitments to liberalize trade in health services in the Uruguay Round. In fact, only education services saw fewer WTO members make liberalization commitments. WTO services data[98] for 122 WTO members on specific commitments to liberalize trade in health services show that:

---

[97] J. Butkeviciene and D. Diaz, "GATS Commitments in the Health Services Sector and the Scope for Future Negotiations," in Zarrilli and Kinnon, *A Development Perspective*, op. cit., 135-158.

[98] Europa, European Union website, "Opening World Markets for Services: Legal Texts and Commitments" (http://gats-info.eu.int/inex.html).

- 35 members (29 percent of the WTO membership) made commitments on medical and dental services;
- 12 members (10 percent of the WTO membership) made commitments on the services of midwives, nurses and physiotherapists;
- 27 members (22 percent of the WTO membership) made commitments on hospital services; and
- 12 members (10 percent of the WTO membership) made commitments on other human health services.

No commitments were made by Canada in any of the above GATS health services categories. With the exception of limited commitments for hospital services, the United States was also non-committal. Commitments were made by the EU on the following services: medical and dental; midwives, nurses, physiotherapists; and hospital. In many cases, however, restrictions were put on the commitments to liberalize trade (e.g. no commitment on the mobility of labour; market access of professionals being restricted to natural persons, and made subject to economic needs tests, supply factors such as shortages of doctors and manpower planning factors, nationality and annual quotas; and market access to hospital services limited by health services plans, needs tests and prior authorization).

Butkeviciene and Diaz[99] are of the view that there have not been any policy implications for WTO members that made GATS commitments on health services because those commitments reflected the status quo and excluded sensitive areas.

The paucity of commitments on health services reflects the wider failure of the Uruguay Round to achieve substantial liberalization in services trade more generally. Some attribute this failure, in part, to weaknesses in the conceptualization and design of the GATS that created too much flexibility and scope

[99] J. Butkeviciene and D. Diaz, "GATS Commitments in the Health Services Sector and the Scope for Future Negotiations," op. cit., 135.

for countries to maintain existing protective trade measures (e.g. not enough transparency, an approach to liberalization based on sectors and modes of supply, conditional obligations).[100] [101] [102] Another problem, noted by Feketekuty,[103] is a lack of clarity and user friendliness in the GATS – something sure to induce caution, if not reluctance, on the part of negotiating countries.

Weaknesses in the GATS architecture may have played some part in the fact that most countries did not liberalize trade in health services. But undoubtedly more was at play in the defensive positions adopted. For services in general, there was a tendency for a country's income and its GATS trade liberalization to be directly related (i.e. higher-income countries scheduled more service sectors for liberalization).[104] That relationship doesn't appear to hold for health services. Why? As noted earlier in the paper, higher-income countries tend to have health care systems with universal insured coverage and largely state financing. This may explain two possible key reasons why these countries have not undertaken substantial trade liberalization. First, these countries may consider their public health services to fall outside the GATS definition of services

---

[100] R. Adlung, "Services Trade Liberalization from Developed and Developing Country Perspectives," op. cit.

[101] B. Hoekman, "Assessing the General Agreement on Trade in Services," op. cit.

[102] P. Sauvé, "Assessing the General Agreement on Trade in Services: Half-Full or Half-Empty," *Journal of World Trade* (Vol. 29, 4, 1995): 125-145.

[103] G. Feketekuty, "Assessing and Improving the Architecture of GATS," in P. Sauvé and R.M. Stern (eds.), *GATS 2000: New Directions in Services Trade Liberalization* (Washington, D.C.: The Brookings Institution, 2000), 85-111).

[104] B. Hoekman, "Assessing the General Agreement on Trade in Services," op. cit.

and, therefore, not be subject to trade negotiations (according to GATS Article I (3)(b)(c), "services supplied in the exercise of governmental authority" are not considered services for GATS purposes). Second, the choice of a public health care system characterized by universal coverage and equitable access to services reflects an approach to health care as a public good rather than a market or tradable commodity. In this case, commercial activity through trade liberalization in health services would be seen as incompatible with the nature of the good.

Countries with public health care systems were not the only ones, however, to limit or abstain from liberalizing health services. A most obvious example is the United States. Despite its predominantly private health care system, and a role in the Uruguay Round as one of the main "instigators, facilitators and mediators,"[105] the United States undertook limited trade liberalization in its health sector.

In conclusion, the expansion of international trade is inevitable, and there will be increasing pressure to liberalize trade in health services through multilateral trade agreements such as the GATS. A better understanding of international trade and health services is hampered by an absence of detailed data, information and knowledge. There is a real need for the health policy and research communities to help develop the information, knowledge and understanding needed for informed decision making in this area. This present overview of international trade and health suggests that the issues are complex and the stakes high.

---

[105] R. Adlung, "Services Trade Liberalization from Developed and Developing Country Perspectives," op. cit.

Trade and the Environment: Post-Seattle Looking Forward

Robert T. Stranks
Environment Canada

The opinions expressed in this document are those of the author and do not necessarily reflect the opinions of the Government of Canada or Environment Canada.

Introduction

The trade and environment policy interface is about good governance. It is about trade governance in an integrated global market, and about sound environmental stewardship in an equally integrated, if not more so, physical environment. Moreover, trade governance and environmental stewardship have the same goal – a high quality of life. The difference is that trade is very much a means, while the environment is a means and an end.

This paper provides an overview of the debate on trade and environment in a multilateral context, and highlights the diversity of the issues and challenges involved. The paper has two parts: an overview of the trade and environment interface; and some views on a way forward in the wake of the World Trade Organization (WTO) Ministerial meeting held in Seattle in December 1999.

An Overview of the Debate

Increasing interdependence

For a considerable number of years, global trade and foreign direct investment growth have increased at a faster rate than growth in overall economic activity. This has resulted in a transformation of the global economy from a state of essentially *independent* economies, trading a relatively small share of their domestic production, to a situation where economies are essentially *interdependent,* trading a larger share of their domestic production. At the same time, reflecting the fragmentation of production across borders due to the vast expansion of foreign direct investment, the global economy has evolved from what has been termed a model of "shallow integration" to a model of "deeper integration."

As a result, trade policy has become a more important element of economic policy overall, and the focus of trade policy has shifted from the tariff and other border measures to issues such as subsidies and government procurement practices, which were traditionally seen as purely domestic but which are now increasingly giving rise to trade frictions.

Coinciding with this trend, at least in the developed countries, has been a greater political interest in the relationship between economic policy and regulation in other policy spheres, including environmental policies and regulations.[1] In an international context, the trade-environment linkage has been on

---

[1] A recent U.S. poll is revealing. When asked what should be a major priority of U.S. trade agreements, a large majority of respondents said protecting the environment (80 percent major priority, 14 percent minor priority). By comparison, with respect to keeping foreign markets open to U.S. exports, 56 percent saw this as a major priority and 32 percent as a minor priority. So at least in the United States, there are indications that the public considers trade agreements significant environmental instruments. Source: *Business Week,* April 24, 2000.

the international agenda in various forums, particularly following the 1992 UN Conference on Environment and Development.

The linkages between trade and the environment

The public's general concern has been that, through adverse effects on the environment (in terms of increasing pollution, accelerating resource depletion and contributing to the erosion of the environmental legacy), trade lowers the overall quality of life for both present and future generations. Addressing this concern in an objective manner may well be key to maintaining public support for an open trading system and building support for a strengthened and more open multilateral trading system, including investment.

Assessing how trade or changes in trade policy impact upon and influence environmental conditions is not, however, a simple matter or without inherent uncertainties. Krueger and Grossman have outlined three mechanisms through which trade and foreign investment policy can affect the level of pollution and the rate of resource depletion. These mechanisms are the *scale effect* (where an increase in trade and investment liberalization leads to an expansion of economic activity), the *composition effect* (where liberalization leads to a change in the composition of products that an economy produces), and the *technique effect* (where technological change is associated with trade and investment).[2] The Organization for Economic Co-operation and Development (OECD) has provided a still finer taxonomy of effects (breaking out product effects, technology effects, regulatory effects, scale effects and structural effects); and the NAFTA Commission on

[2] G.M. Grossman and A.B. Krueger, "Economic Growth and the Environment," *Quarterly Journal of Economics* (1995).

Environmental Co-operation (CEC) has also developed methodologies for assessing trade-related environmental effects.[3]

Some of the trade-environment interactions are direct, such as the import and export of environmentally friendly or hazardous products. Others are indirect, such as the positive influence of trade on per capita incomes, which in turn stimulates demand for a cleaner environment, or the positive impact of trade on the level of economic activity, which in turn creates pollution.

When assessing the impact of trade on the environment, the quality of environmental policy must, however, also be considered. When environmental policies are not set appropriately, trade and investment can indeed serve to aggravate environmental problems. However, in a context of sound environmental policies, available evidence suggests that trade and investment usually will have a positive impact on the environment.[4]

For example, if domestic prices for products are distorted, such as through subsidies, trade and trade liberalization may have an adverse environmental impact. In this regard, a World Bank report concluded that "Some government polices are downright harmful for the environment. Notable here are

---

[3] See Commission on Environmental Co-operation, *Assessing the Environmental Effects of the North American Free Trade Agreement (NAFTA)* (Montreal: CEC, 1999); and Organization for Economic Co-operation and Development, *Methodologies for Environmental and Trade Reviews* (Paris: OECD, 1994). Both organizations have ongoing work programs in these areas.

[4] A similar argument may be made regarding the impact of economic growth on the environment: in a context of weak environmental policy, growth can damage the environment, but well-framed environmental policies can lead to environmental improvements from economic growth. And let us not forget that lack of economic growth, or a collapse in trade, can contribute to environmental degradation, although this observation is less often made – at least publicly – by critics of the WTO.

distorted prices in general and subsidized input prices in particular."[5] Subsidies to producers or consumers of energy and agricultural products have been identified as particularly damaging to the environment in that they encourage excessive use of fossil fuels, irrigation water, pesticides and logging. The Worldwatch Institute has also documented how subsidies for such activities as mineral production, logging, fishing, agricultural inputs and production, and energy use have contributed to a range of environmental problems.[6]

This, however, does not imply that trade or trade liberalization should be avoided, nor that trade measures are the most appropriate response to subsidization of resource use.[7] Rather, an appropriate domestic environmental policy, crafted to internalize environmental costs, is required to avoid negative environmental impacts. The reduction or elimination of these types of subsidies promotes efficient use of resources, with beneficial effects for the environment as well as for trade.

The linkages between foreign direct investment and the environment

The general public concern regarding the impact of foreign direct investment (FDI) on the environment reflects the fear that differences in environmental standards will promote the relocation of firms to economies with lower effective

---

[5] World Bank, *World Development Report* (Washington: World Bank, 1992), p. 11.

[6] David Malin Roodman, "Reforming Subsidies," in Lester R. Brown et al., *State of the World 1997* (New York: W.W. Norton & Company, 1997).

[7] For a discussion on some of the difficulties of using countervailing duties in response to "environmental subsidies," see Robert T. Stranks, *Pandora's Box?: Countervailing Duties and the Environment* (Ottawa: Department of Foreign Affairs and International Trade, October 1994).

environmental standards (i.e. "pollution havens") and result in a race to the bottom for environmental standards.

The OECD has made several observations in response to this fear.[8] First, there is little empirical evidence indicating that countries lower their environmental standards in order to attract so-called "dirty" industries. Second, there is not much evidence of firms relocating to countries with lower environmental standards in order to take advantage of the lower standards. While firms do move from high- to low-standard countries, the reasons for doing so usually have little to do with environmental standards in either country. Very few firms undertake foreign investment with reduced environmental compliance costs as their primary objective.

This said, as the study notes, the *threat* of industrial relocation is often used by firms who would like to have the burden of environmental policies reduced. Thus, "the threat of industrial migration based on 'pollution havens' (rather than the reality of this migration) may be generating a 'political drag' on environmental policy-innovations in OECD countries."[9]

Summing up the evidence

Accordingly, there is no simple one-to-one mapping between growth in trade and economic activity on the one hand and changes in the environment on the other. Indeed, trade and trade liberalization can relate to the environment in four ways:

1) absolutely beneficial for the environment;
2) neutral in respect to the environment;
3) negative for the environment, but less negative than the same level of economic growth or developments that would

---

[8] Organization for Economic Co-operation and Development, *Economic Globalisation and the Environment* (Paris: OECD, 1997).

[9] Ibid., p. 13.

occur over time in the absence of trade or trade liberalization; and

4) more environmentally negative than the same level of economic growth or developments that would occur over time in the absence of trade or trade liberalization.

While (1) is clearly the preferred outcome, (2) or (3) should also be acceptable from an environmental as well as trade perspective, other things being equal.

The key to this relationship would appear to be technology. International diffusion of technology and the use of efficient (resource-saving) products can be facilitated by freer trade and liberal investment policies.[10] FDI and technology transfer also imply that the links between trade and the environment need to be considered in a long-run framework.

As a matter of global public policy and policy coherence, two points need to be emphasized. First, trade policy (which promotes liberalized trade and investment) and environmental policy (which promotes a high-quality environment) share the common objective of improving living standards. Second, to achieve this objective, co-operation is required because of the interdependence of countries on both of these issues. Furthermore, the challenges of sustainable development are considerable even with maximum co-operation.[11]

---

[10] John Begin and Michel Potier, "Effects of Trade Liberalisation on the Environment in the Manufacturing Sector," in *The World Economy*, 20, no. 4 (July 1997).

[11] In Canada's case, policy coherence is reflected in the aim to ensure that trade rules provide the necessary flexibility to implement effective environmental policies while maintaining the integrity of the multilateral trading system. Canada is generally committed to integrating sustainable development into domestic and foreign policy. With respect to trade and environment, Canada's objectives are as follows: (1) to ensure governments can implement effective environmental laws and policies while preserving the integrity of the rules-based multilateral trading system; (2) to ensure that Canada's environmental policies minimize any adverse trade effects; and

Looking Forward

Addressing the trade and environment interface in the post-Seattle WTO Ministerial environment will be a challenge, both in terms of developing domestic public support and in terms of developing an international consensus to move forward. Any Canadian strategy to confront this challenge must take into account that Canada (a) is integrated into the global economy and multilateral trading system; (b) has important environmental interests both domestically and in terms of the global commons; (c) is party to a number of international environmental agreements; and (d) is party to an already existing dynamic international environmental "architecture." Importantly, as events surrounding the Seattle Ministerial vividly illustrated, the strategy must, in its design and implementation, be fully open, with an ongoing dialogue maintained with Canadian civil society in addition to traditional stakeholders. Lastly, and most importantly, the trade and environment agenda must take into account the development aspirations of the developing countries if there is to be any real prospect of arriving at a satisfactory outcome.

One way forward might be characterized as a "WTO-plus" approach. This approach places trade and environment issues into three categories: those that need to be addressed within the WTO; those that involve co-operation between the WTO and other international institutions; and those that can be addressed outside the framework of the WTO.

---

(3) to promote sound environmental practices and improve market access for environmental goods and services.

WTO members have made an explicit commitment to sustainable development and the protection of the environment. This commitment is enshrined in the preamble to the WTO Act. Thus, while not being an environmental organization nor being charged with administering any specific substantive agreement dealing with the environment, the WTO supports the concept of sustainable development and recognizes that there are linkages between trade and environmental issues. As well, at the Seattle Ministerial, the developing countries stressed that development was also an inherent consideration in multilateral trade negotiations.

Upon its establishment on January 1, 1995, the WTO created the Committee on Trade and Environment (CTE) to pursue a work program on trade and environment issues set out in the Marrakech Decision.[12] To address its mandate in a systematic manner, the CTE has adopted the so-called "cluster approach." The first cluster consists of items relevant to the theme of market access, and the second cluster consists of items related to the linkage between the multilateral environment agenda and the multilateral trade agenda.

The issues of particular interest to Canada that are currently being discussed in the CTE are as follows:

- *Multilateral Environmental Agreements (MEAs):* Canada supports further work in the CTE to clarify the relationship between WTO rules and trade measures in the MEAs. While no MEA has been challenged to date in the WTO, this provides little comfort for the future. Canada has proposed a "principles and criteria" approach to clarify WTO rules. Such an approach would assist WTO panels in assessing trade measures

[12] WTO Trade and Environment Decision of April 14, 1994.

contained in MEAs, and assist those developing MEAs in constructing WTO-consistent trade measures.[13]

- *Eco-labelling:* Canada supports eco-labelling on a voluntary basis but seeks to avoid the risk inherent in mandatory schemes of their becoming hidden trade barriers. Within the CTE, Canada supports further discussion of non-product processes and production methods (PPMs) with respect to voluntary standards.
- *Market Access:* Canada supports liberalization of trade in environmental goods and services on the grounds that the technology that they embody would enhance the ability of countries around the world to deal with environmental challenges.
- *Subsidies:* The CTE has had some initial discussions on subsidies. It is widely acknowledged that there are potential environmental benefits from removing trade restrictions and distortions in a number of sectors, such as agriculture, energy and fisheries. For example, trade-distorting subsidies to the fishing sector also contribute to a build-up of excess capacity and undermine the sustainable use of marine resources. Particular aspects of subsidies will be negotiated as part of the WTO's "built in" agenda, for example the "green box" in the agricultural sector, but a broad-based discussion of subsidies in an environmental context would be appropriate for the CTE.

Other environment-related issues that may be appropriate for a CTE with a broadened mandate to consider are:

- *The Application of Precaution:* The application of precaution, which is often expressed by the terms "precautionary principle" and "precautionary approach," is particularly relevant to the WTO's Agreement on

[13] It should be noted that while this activity is within the WTO, it involves inter-institutional co-operation.

Sanitary and Phytosanitary Measures (SPS Agreement). The SPS Agreement recognizes the legitimate right of governments to maintain the level of health protection they deem appropriate but ensures at the same time that the right is not abused and does not result in unnecessary barriers to trade. The Agreement explicitly recognizes the right to take precautionary provisional measures when scientific evidence is lacking, while seeking further information.

- *Processes and Production Methods:* Article III of the General Agreement on Tariffs and Trade (GATT), which provides for "national treatment," precludes discriminatory treatment of imports compared to domestic products – including discrimination based on PPMs used in the product's development. Since different PPMs have varying environmental consequences, the question arises from an environmental perspective as to whether countries *should* be able to treat products differently (including the right to impose import restrictions) on the basis of PPMs. This is a highly contentious issue, given the difficulty of distinguishing "beggar-thy-neighbour green protectionism" from environmental protection. This issue, and others such as subsidies, could also be linked to MEAs.
- *Trade and Foreign Investment:* The question of whether a framework of multilateral rules on foreign investment should be established in the WTO is a contentious issue. This, however, does not alter the fact that there are significant relationships between foreign investment, trade and the environment. Most notable is the impact of foreign investment on economic growth and development.

The CTE's progress in advancing its work program has been, in the view of some observers, somewhat less than sterling, leading them to conclude that high-level multilateral and

bilateral discussions are needed to elicit real commitment to integrating trade and environment concerns, and to bringing economic development considerations into the equation for a sustainable development approach.[14]

Outside of the CTE, there are three possible ways to advance the environmental agenda within the WTO.

First, environmental considerations could be included in the negotiations on agriculture and services trade that, as per the "built-in agenda" of the Uruguay Round, commenced in 2000. In developing its position for the Seattle Ministerial, Canada announced that it would indeed seek to ensure that environmental considerations are fully taken into account, at least in the context of Canadian participation in the negotiations. There is, however, a wide range of views amongst WTO members on having environmental issues explicitly reflected in these negotiations.

Second, trade and environment could be addressed in Trade Policy Review Mechanism (TPRM) reviews of WTO members' trade policies and performance. This mechanism has three broad objectives: first, to increase the transparency and understanding of members' trade policies and practices, through regular monitoring; second, to improve the quality of public debate on issues; and third, to enable a multilateral assessment of the effects of policies on the world trading system. From an

---

[14] In December 1996, the CTE's report to the first WTO Ministerial in Singapore demonstrated progress in terms of the WTO's recognition of the legitimacy of environmental policies. However, the report was disappointing from an environmental point of view in that there were few, if any, concrete steps toward integrating the environment into trade rules. The primary reason for the lack of results in the report to Singapore was a polarization between developed and developing countries. The latter view trade and environment as an issue that can only hurt them, in the sense of legitimizing the use of environmental measures as non-tariff barriers limiting their exports. They were therefore not interested in clarifying or modifying trade rules in such a way as to provide greater flexibility for environmental measures. This situation has not really changed since Singapore.

environmental perspective, the first two of these objectives in particular could contribute to trade and environment transparency objectives. For WTO members such as Canada that undertake a trade-related environmental assessment or environmental review, the environmental component in a TPRM exercise would parallel their national initiatives and serve to demonstrate to the public that environmental issues are being taken into account in developing their negotiating positions, and that trade liberalization can contribute to sustainable development.[15] However, to be broadly acceptable in the current international political climate, the inclusion of environmental considerations in a TPRM might have to be made optional for each WTO member. The review of the operation of the TPRM mandated in the built-in agenda of the Uruguay Round affords an opportunity to address this idea.

Third, and complementary to the outreach work being done within the CTE, Canada and a number of other WTO members support further outreach efforts by the WTO. Increased transparency of WTO operations, including more outreach by the Secretariat, would help maintain and build public support for the multilateral trading system. Canada has put forward a proposal on transparency and in particular noted the need for a regular budget to fund WTO outreach activities and for faster de-restriction of documents. Canada also believes that WTO members have a responsibility to inform their domestic stakeholders with respect to the WTO negotiations and provide adequate opportunities for consultation.

Given the public's interest in the WTO, and the criticism by some of the organization, increased transparency and outreach

---

[15] For example, Canada's environmental review of WTO trade agreements and negotiations is a fundamental and publicly visible component of the trade strategy. In preparation for the Environmental Review, the Department of Foreign Affairs and International Trade released a paper entitled *Retrospective Analysis of the 1994 Environmental Review of the Uruguay Round* (Ottawa: November 1999).

to promote understanding of the complexities of the trade and environment linkage is desirable.

With the WTO

The prime area where an inter-institutional approach is warranted is in clarifying and managing the relationship between MEAs and the WTO. The potential for MEAs and the WTO to come into conflict over the use of trade measures cannot be resolved in either environmental institutions or the WTO. A joint approach is required.

A second general area where inter-institutional co-operation would clearly be warranted is in research and analysis. In this regard, the OECD's analytical work on methodologies for the environmental assessment of trade liberalization is an example of where inter-institutional co-operation with the WTO has been recognized as contributing to moving the trade and environment agenda forward. In general, links between the OECD and WTO allow the greater analytical capacity of the OECD to be made available to, but the results and analysis not imposed upon, the members of the CTE. Other international bodies such as the United Nations Development Program (UNDP) and the United Nations Conference on Trade and Development (UNCTAD) also have a useful role to play in assisting the CTE in increasing its understanding of integrating environmental and sustainable development concerns into the multilateral trading system. In this regard, the WTO and the United Nations Environment Program (UNEP) have already concluded a co-operation agreement on trade and environment. One example of where future inter-institutional work will be required is to more fully understand the relationships and implications of the Kyoto Protocol and, more broadly, the potential linkages between trade and possible trade measures with climate change.

One suggestion for advancing the agenda has come from the International Institute for Sustainable Development (IISD) and the World Conservation Union (IUCN). The IISD and IUCN have proposed the convening of a Standing Conference on Trade and Environment (SCTE), whose aim would be to promote coherence in environmental policy as it relates to trade. The Conference would consist of the key environmental actors with an interest in trade policy, such as intergovernmental organizations and key elements of civil society, and seek to formulate practical recommendations for consideration in the WTO and other policy forums. In terms of logistics, the SCTE could function as an ongoing network with an annual conference.

Finally, to enhance its credibility and effectiveness, the WTO needs to be open to input from, and to maintain an ongoing dialogue with, environmental experts and a number of other international organizations. To its credit, the WTO has been engaged in this type of activity and the CTE has granted observer status to a number of international organizations including the International Monetary Fund (IMF) and World Bank. The WTO has also sponsored symposia on trade and the environment that have involved many civil society organizations (CSOs). These initiatives are consistent with the preamble of the WTO to ensure that the multilateral trading system is responsive to environmental and sustainable development concerns.

Outside the WTO

Enhanced international environmental co-operation and strengthened international environmental institutions could lessen the potential for conflict between trade and environment policies, quite independently of any direct involvement of the WTO. This could take a number of forms.

The most straightforward way would be to ensure effective implementation of the existing MEAs through enhanced support for capacity building and enhanced compliance mechanisms. Improved capacity-building provisions in MEAs would both make it more attractive for developing countries to support them and would improve the effectiveness of the MEA once it had been negotiated. Enhanced compliance mechanisms in MEAs would likely lessen the likelihood of trade-related MEA disputes being taken to the WTO rather than being resolved in the MEA. The real instruments and attractiveness of MEAs for developing countries would be the promotion of financial, technical and human resource capacities. This would make it attractive to become parties to the MEA and avoid undesirable environmental and economic competitiveness consequences.[16]

A second way would be to negotiate additional MEAs. Currently, MEAs are limited to a few specific trans-boundary or global environmental problems of particular concern. However, new MEAs on, for example, processes and production methods, could reduce the widespread concern within the environmental community that trade liberalization will exacerbate competitiveness-driven pressures for lower environmental standards. It would also be worthwhile to examine what steps the international community could take to raise international environmental standards more generally – although here it must be recognized that MEAs have their own limitations, and that environmental standards will for a number of reasons vary across countries, so some flexibility will be necessary.

---

[16] In addition to considering capacity-building programs within the international environmental institutions, there is a need to consider the trade and development interface in a broader context and, in particular, the role that official development assistance can play in helping developing countries face trade and development challenges. In this regard see Kerry David Max, "Addressing Trade-Related Development Needs: Options for the Donor Community" in the present volume, which provides a number of suggestions for the overall co-ordination of trade-related development assistance.

Third, international institutional capacity and co-operation for the advancement of sustainable development can also be strengthened quite independently of the WTO.[17] Increased coherence and co-operation among international institutions such as UNEP and UNDP, UNCTAD, WTO, the World Bank, etc., would serve to enhance global environment-economy integration. While capacity building in environmental policy does not directly impact on multilateral trade rules, it does play a significant role in determining what the environmental effects of actual trade flows will be. And the environmental impact is an important variable in the public's assessment of the cost and benefits of trade liberalization, and consequently support for, or hostility toward, the multilateral trading system.

Illustrative of this approach is the UNCTAD and UNEP initiative to establish a Capacity-Building Task Force for Trade, Environment and Development (CBTF).[18] The initiative is being driven by demand from developing countries as well as by the desire to co-ordinate the organizations' various trade- and environment-related activities. The overall purpose of the CBTF will be to strengthen capacity, particularly within developing

---

[17] The recent Malmo Ministerial Declaration reflects a growing view that a lack of coherence and co-ordination among international agreements and institutions poses a major impediment to global sustainable development. See UNEP, *Global Ministerial Environment Forum*, Malmo, Sweden, May 2000. A related issue is that of gaps in the existing global environmental institutional "architecture": as well articulated at UNCED in 1992, MEAs do not fully take into account all aspects of sustainable development; however, this does not imply the need to create a global environmental organization, which is unrealistic at this time. See Robert T. Stranks, *Unfinished Business: Toward a Global Environmental Organization* (Ottawa: Department of Foreign Affairs and International Trade, July 1995).

[18] More generally there is a question of adequate and long-term funding for international environmental institutions, such as UNEP. The internal capacity of international environmental institutions will strongly influence their own effectiveness and their ability to contribute to increased coherence and co-operation.

countries and economies in transition, to effectively address trade-environment-development issues. It is intended that the CBTF undertake a number of activities such as thematic research, country studies, training, policy dialogue and networking and information exchange.

Finally, trade is also more than multilateral trade rules. A wide range of variables, such as consumer preferences, not within the scope of the WTO's mandate influence actual trade flows. For example, while UNEP does not have a mandate to address WTO trade rules and the environment, its work program on "Technology, Industry and Economics" has the objective of contributing to improving the understanding and knowledge of environmental issues related to industrial and urban development, trade and the economy, sustainable consumption patterns, increased use of natural resources, and chemicals. UNCTAD's interest is in enhancing the transfer and diffusion of technologies to developing countries. Such initiatives, while focussed on technology, have important implications for both trade and the environment. These activities, particularly their funding aspects, are not appropriate for the WTO. Clearly, there is a potential for developing synergies amongst the various specialized institutions with an interest in trade and the environment. Countries need to work collectively toward developing a work plan to encourage international institutions to maximize these synergies.

Concluding Observations

The foregoing discussion points toward the conclusion that the trade and environment policy interface is fundamentally about good governance. Trade and environmental policy share the goal of improving the quality of life. To reach this goal, trade and environmental policy must also share the goal of avoiding

the use of environmental measures for trade protectionist purposes.

To inform an anxious public, and to contribute to effective and coherent public policy making, further substantive understanding of the linkages between trade and the environment is required. Such an understanding can be enhanced through a coherent agenda with interrelated work within the WTO, by the WTO in co-operation with other international institutions, and outside the WTO. Moreover, the paper suggests that the trade and environment interface needs to be considered in a broader sustainable development context. The latter is necessary not only to develop a full appreciation of the complexity of the issues, but also to better engage developing countries in order to reduce mistrust and misunderstanding.

The year 2002 will mark the 10th anniversary of the Rio Earth Summit. Canada would like to see Rio+10 address cross-cutting organizational, strategic and policy issues. At the core of these issues is the need for a clear and coherent framework of global environmental governance within which efforts to protect the global environment, whether those be domestic, bilateral or multilateral, can take place. One of the important questions the international community will need to consider over the next two years, as part of the preparations for Rio+10, is how to engage developing countries in the global sustainable development agenda, and strengthen their capacity to contribute to international efforts to address global environmental challenges. Over the coming years, a number of international institutions, including the WTO, have an important role to play in this regard.

Trade, Employment and Wages: A Review of the Literature

Philippe Massé
Human Resources Development Canada

This paper was prepared on behalf of the PRI-GCON Working Group on World Trade Issues. The author is with the Applied Research Branch at Human Resources Development Canada (philippe.masse@spg.org). The opinions expressed in this paper are those of the author and do not necessarily reflect the views of Human Resources Development Canada.

Introduction

The impact of increased trade and investment liberalization on employment and wages is a matter of considerable debate. Those opposing freer trade argue that rising imports from low-wage developing countries are displacing low-skilled workers in advanced economies. Investment liberalization is seen as exacerbating this problem by enabling multinational enterprises to relocate their manufacturing operations to take advantage of low wages in these countries. These developments are seen as a primary cause of the decline in relative employment and wages of low-skilled workers and of rising income inequality and/or unemployment in many countries, including Canada, particularly in the early 1990s.

Proponents of liberalization, on the other hand, argue that trade and investment liberalization results in a reallocation of resources to areas of comparative advantage, thereby raising productivity and growth over the long term. This in turn

provides the basis for improvement in employment and wages, offsetting any short-term employment losses and transitional problems for some groups of workers.

In Canada, the debate over the labour market impacts of trade have focussed more on the Canada-U.S. Free Trade Agreement (FTA) and the subsequent North American Free Trade Agreement (NAFTA) than on trade with developing countries, but the underlying anxieties appear to be similar. Indeed, the Canadian manufacturing industry suffered significant employment losses in the period following the implementation of the FTA. As Gaston and Trefler (1997) state: "Nothing has undermined the position of free-traders more than the dismal performance of Canadian manufacturing employment since the implementation of the Canada-U.S. FTA."

This paper reviews the evidence on the impact of trade on employment and wages. First, the theoretical mechanisms through which trade and foreign investment impact on labour markets are discussed. This is followed by a brief review of the main theories on the labour market impacts of international trade, an examination of the evidence regarding the impact of trade on employment creation and an examination of the impact of trade and investment with developing countries on domestic employment and wages. The paper concludes by briefly outlining some general policy issues and identifying some knowledge gaps.

Trade and Labour: Theoretical Considerations

Before examining what theory predicts about the impact of trade on labour markets, it is useful to briefly examine recent Canadian trends in trade and investments abroad.

Over the 1990s, Canadian exports and imports of goods and services increased significantly, roughly doubling between 1990 and 1999. As a result, the Canadian economy has become increasingly outward-oriented. The ratio of exports and imports to GDP increased from 26 percent respectively in 1990 to 43 percent and 40 percent respectively in 1999 (Industry Canada, 2000a).

Most of the growth in Canada's trade has occurred with the United States at the expense (in relative terms) of other regions (see Table 1). The U.S. share of Canadian exports increased from 74.2 percent in 1990 to 86.8 percent in 1999. Similarly, the U.S. share of Canadian imports increased from 64.5 percent to 67.3 percent between 1990 and 1999. The share of Canada's trade with other regions (exports and imports) tended to decline over this period. In general, Canada trades with other developed countries. In 1999, roughly 95 percent of Canadian exports and 90 percent of Canadian imports were exchanged with other countries of the Organization for Economic Co-operation and Development (OECD).

Table 1
Canadian Merchandise Export and Import Market Shares by Region

	Export Shares		Import Shares	
	1990	1999	1990	1999
United States	74.2	86.8	64.5	67.3
EU	8.9	4.7	12.7	9.9
Latin America	1.9	1.6	3.4	4.6
Asia-Pacific	10.9	5.2	14.0	13.3
Other	4.2	1.7	5.4	4.8
OECD	92.2	95.7	89.7	87.9

Source: Industry Canada, Trade Data Online (http://strategis.ic.gc.ca/sc_mrkti/tdst/engdoc/tr_homep.html).

Recent trends in Canadian direct investment abroad (CDIA) have also contributed to increasing the outward orientation of Canada's economy. Between 1988 and 1998, the stock of CDIA approximately tripled. As a result, CDIA as a share of GDP increased from 14.8 percent to 30.9 percent over that period (Industry Canada, 2000b).

Most CDIA is directed toward the United States. However, the U.S. share of total CDIA declined during the 1990s, falling from 64 percent in 1988 to 53 percent in 1998 (see Table 2). The Latin American share of CDIA increased the most, rising from 8.7 percent to 18.1 percent over that period. CDIA to the European Union and Asia-Pacific regions also increased slightly. As is the case with trade, however, the destination of most CDIA was to developed countries, with the United States and the EU accounting for around 72 percent of total outflows.

Table 2
Distribution of Canada's Stock of Direct Investment Abroad, by Region

	1988	1998
United States	64.0	52.6
European Union	17.7	19.3
Latin America	8.7	18.1
Asia-Pacific	5.4	6.1
Other	4.3	3.9

Source: Industry Canada (2000b), "Trends in Canada's Outward FDI – An Analysis of the New Database" (http://strategis.ic.gc.ca/pics/ra/ofdi_e.pdf).

Theories of international trade

There are two main theoretical approaches that describe the channels through which international trade might impact on the labour market. The first is the Hecksher-Ohlin (H-O) theory of

comparative advantage, which offers predictions about the impact of trade between countries with different resource endowments that can be applied to the case of trade between developed and developing countries. The second approach is subsumed in what are called "new trade theories" that were developed to describe trade between developed countries with similar resource endowments. As seen above, most world trade today occurs between developed countries.

The H-O theory posits that comparative advantage arises from differences in relative endowments of factors of production (e.g. land, natural resources, labour and capital). Countries will therefore specialize in the production of goods that use their relatively abundant factor. Skilled labour is relatively more abundant in developed countries, while unskilled labour is relatively more abundant in developing countries. Thus, the theory predicts that, in their trade with developing countries, developed countries would export skilled-labour-intensive goods and services and import unskilled-labour-intensive goods and services. There is evidence that this prediction indeed does reflect actual patterns of trade between developed and developing countries (OECD, 1994).

According to this theory, an intensification of trade with developing countries would, therefore, tend to reduce the demand for low-skilled workers in developed countries as well as their relative wages, all other things being equal. The magnitude of the impact on relative wages would depend on their responsiveness to changes in demand. In countries where wages are flexible, such as the United States and Canada, increased trade with developing countries would tend to lead to a fall in the relative wages of low-skilled workers. In countries where wages are more rigid, such as in Europe, increased trade with developing countries would be reflected mainly in higher unemployment for low-skilled workers.

Another prediction of the H-O theory is that trade will lead to a convergence in factor prices across countries. This tendency

would also be reflected in the price of traded goods.[1] Researchers looking to estimate the magnitude of the impact of trade on OECD labour markets will often look at whether the prices of goods that are subject to import competition exhibit a tendency to fall.

The so-called "new trade theories" were developed to explain the fact that most OECD trade is between countries with similar factor endowments and is characterized by intra-industry trade of similar (but differentiated) products. In developed countries, the production of manufactured goods is primarily characterized by imperfect competition where specialization leads to lower costs via economies of scale and hence improved competitiveness. In the presence of economies of scale, the enlargement of markets permits further cost reductions for the firm and there will be an incentive to export if trade barriers are reduced. One of the main predictions of the theory is that intra-industry trade will be more intense between countries with similar incomes, tastes and production structures.

According to the new trade theories, the gains from trade occur because production costs fall as the scale of output increases, which translates into lower prices. However, the theory's predictions about the impact of intra-industry trade on relative wages are ambiguous. Changes in the demand for, and hence the wages of, high- and low-skilled workers will depend on how the production of some goods falls and of others increases. The demand for unskilled workers will depend on the types of technologies used in expanding and declining firms and how the technologies themselves change in response to changes in the level of production. It is therefore possible that developed countries will export both skilled-labour-intensive and unskilled-labour-intensive products.

---

[1] This is also known as the Samuelson-Stolper Theorem, which shows that, under certain conditions, trade will lead to the equalization of the prices of factors and of goods.

However, while society as a whole benefits from lower prices and higher consumption possibilities, the displacement of resources invariably creates losers. In a context where more recent waves of technological change appear to have favoured more skilled workers, the losers may well be unskilled workers.

Trade and Employment: The Canadian Experience

Studies of the impact of trade on employment in Canada focus mostly on the experience of the 1970s through to the early 1990s. During this period, the structure of employment in Canada shifted, with the share of manufacturing declining relative to services. In the 1980s, the manufacturing sector actually suffered net job losses as employment declined by about 0.5 percent per year between 1981 and 1991 (Gera and Massé, 1996). In general, manufacturing employment losses were concentrated in low-technology, labour-intensive sectors, while high-technology, skill-intensive sectors experienced employment gains (Gera and Massé, 1996; Baldwin and Rafiquzzaman, 1998).

What is the role of trade in explaining these employment patterns? Input-output analysis (I/O) conducted by Gera and Massé (1996) suggests that the importance of trade in explaining changes in the industrial structure of employment increased during the late 1980s and early 1990s. That is, trade now accounts for a larger share of employment variations relative to other factors such as domestic demand and productivity than was the case during the 1970s.

In the manufacturing sector, the study found that exports have become a dominant factor in employment growth in high-technology and skill-intensive industries, while import penetration adversely affected employment growth in low-technology, labour-intensive industries. This is consistent with international evidence which shows that trade has been

associated with job losses in labour-intensive sectors such as textiles, clothing, wood and leather (OECD, 1994, 1996).

The role of trade in explaining employment changes in service industries also appears to have increased. While domestic demand remains the main determinant of employment in services, the study found that exports and imports explain a larger share of employment changes in services in more recent years, particularly in the 1980s. Exports affected employment positively in "high-knowledge" services such as business services and finance, insurance and real estate. In contrast, import penetration was associated with employment losses in "low-knowledge" services such as transportation services and food and accommodation services, particularly in the second half of the 1980s.

A central question is whether employment gains in export-oriented and related sectors compensate for employment losses in industries facing import competition. It is first worth pointing out that a large number of jobs in Canada depend on exports. Gera and Massé (1996) found that the expansion of exports accounted for around 75 percent of new jobs (1.4 million) between 1971 and 1991. A recent study by Statistics Canada (1999) estimates that in 1995 around one in five jobs in Canada was directly or indirectly related to exports.

On balance, the available evidence suggests that the net impact of trade on employment has been positive. Gera and Massé (1996) found that, despite the negative employment impact of imports, trade accounted for 23 percent (719,000) of net new jobs in Canada between 1971 and 1991. However, during the second half of the 1980s, trade had a small net negative impact on employment.

It is also worth pointing out that imports do not necessarily imply job losses. According to Cameron and Cross (1999), over one third of the rise in the share of exports to GDP has been due to the rising import content of exports, resulting from the increasing international specialization of production. In fact,

import content has increased the most in industries where export growth has been the strongest. There is evidence that the growing import content of exports has led to slower growth in export-related employment than might have been expected given the growth in exports as a share of output (Dungan and Murphy, 1999). However, in the context of growing international specialization, it may no longer be appropriate to view imports, from this narrow labour market perspective, as necessarily destructive of jobs.

Employment impact of the Canada-U.S. FTA

Several recent Canadian studies of the employment impacts of trade have focussed on the impact of the Canada-U.S. FTA implemented in 1989. For example:

- Gaston and Trefler (1997) argue that the FTA was not the primary cause of most of the job losses in the Canadian manufacturing sector during the 1989-1993 period. According to the authors, FTA tariff cuts account for only 15 percent of employment losses. They find that most of the employment losses were due to the recession of the early 1990s, which they attributed to the Bank of Canada's fight against inflation, a consequence of which was high domestic interest rates and a strengthened Canadian dollar.
- Schwanen (1997) argues that the FTA did not contribute to Canada's employment problems in the early 1990s. Sectors most sensitive to the FTA do not appear to have fared worse than manufacturing as a whole. Moreover, he argues that the poor employment performance of some sectors was primarily due to factors other than the FTA – for example, import competition from non-U.S. sources (leather and electronics products), the recession

(construction materials) or long-term decline not related to trade (fish products, shipbuilding).

- Trefler (1999) finds that the FTA reduced employment in manufacturing by about 5 percent over the 1988-1996 period. Industries exposed to large tariff cuts experienced relatively large employment declines of about 15 percent over that period.

In general, the evidence suggests that the employment impact of the FTA, while largely negative in the most affected sectors, appears to have been small relative to total employment. The available evidence does not allow an assessment of whether the FTA has resulted in net employment gains or losses. Factors other than the FTA also appear to have played an important role in the evolution of employment. Restrictive macroeconomic policies, the appreciation of the Canadian dollar, and the early 1990s recession clearly make it difficult to isolate the impact of the FTA.

In sum, there is little evidence that trade in general or the FTA in particular has led to large employment losses overall. Viewed over a long period, trade appears to have contributed positively to employment growth in Canada. That said, where trade has had a negative impact on employment, it has been mostly in low-technology, labour-intensive sectors, which employ large numbers of low-skilled workers.

Trade, Employment and Wages: The Experience of Low-Skilled versus High-Skilled Workers

There is an ongoing debate over the role of trade with developing countries in explaining the decline in the relative employment prospects and wages of low-skilled workers and increased income inequality in developed countries. There is disagreement among researchers over the magnitude of the trade

impact relative to that of other factors such as technological progress and institutional changes.

There are essentially two types of empirical approaches that attempt to measure the impact of trade with developing countries on the employment and wages of low-skilled workers: factor content studies and price effect studies. Factor content studies attempt to calculate the number of low-skilled workers employed in the production of a particular country's exports and the amount that would have been employed to produce that country' imports. The net impact of trade is interpreted as being the difference between the two. Price effect studies examine if the relative price of unskilled-labour-intensive goods have fallen as predicted by the factor price equalization theorem discussed above.

According to recent reviews of both factor content and price effect studies (mostly based on U.S. experience), the OECD (1996, 1997, 1998, 2000) concludes that trade is not the main driving force behind increased demand for skilled workers in OECD countries. There is evidence that trade did contribute to the declining fortunes of low-skilled workers and increased income inequality, but the effect was limited. The OECD (1998) estimates that increased trade with developing countries accounts for only about 10 to 20 percent of the changes in wages and income distribution in developed countries.

Researchers arguing that the impact of trade is small often point to the fact that industrialized countries primarily trade with each other. As shown above, around 90 percent of imports to Canada come from other OECD countries. Although trade with developing countries is increasing, it still represents a small part of total trade in manufactured goods.

There are only a few studies on the link between trade and the relative wages of low-skilled workers in Canada. These focus on the manufacturing sector only and offer somewhat conflicting evidence. Some find a positive impact of trade on the relative wages of low-skilled workers in Canada. For

example, Trefler (1999) finds that the FTA increased the relative wages of production workers relative to non-production workers in manufacturing. Gu and Whewell (2000) find that imports to Canada are in fact more skilled-labour-intensive than Canadian manufacturing exports and suggest that increased trade has not hurt the wages of unskilled versus skilled workers.

In contrast, Baldwin and Rafiquzzaman (1998) find a direct link between increases in the wage premium of skilled workers and changes in trade intensity. Sectors where import competition increased the most (labour-intensive, product-differentiated and natural resources sectors) also saw the largest increases in the wage premium of non-production workers. However, these results are not directly comparable to those above, as the authors examine changes in relative wages at only a sectoral level and do not provide evidence for manufacturing as a whole.

The evidence suggests that while trade has indeed had some negative impact on the demand for low-skilled workers, the effect remains relatively small compared to other factors. While there is still disagreement among researchers, there is a growing weight of opinion that technological change favouring skilled workers is probably the dominant factor (OECD, 1996, 2000). In Canada, the evidence suggests that the increase in the demand for skilled workers is widespread across all sectors of the economy (Lavoie and Roy, 1998). This evidence suggests that the source of employment changes is systemic and is consistent with the technological change argument. There is also more direct evidence of a positive link between measures of technological change and the employment of skilled workers (see, for example, Lavoie and Therrien, 1999; Gera, Gu and Lin, 1999; Baldwin, Gray and Johnson, 1997).

In reality, growing trade and technological change are interrelated processes. For example, increased international competition may induce firms to adopt new technologies to remain competitive. Conversely, new technologies support the

expansion of international trade by providing the basis for increased specialization and increased economies of scale, enabling firms to operate on world markets (OECD, 1994). Indeed, Baldwin and Rafiquzzaman (1998) find evidence that both skill-biased technological change and trade have contributed to increased wage differentials between skilled and unskilled workers in manufacturing industries.

Alternative hypotheses

Most of the literature on the impact of trade on employment and wages has focussed on the role of trade in reducing the demand for unskilled workers in industrialized countries. In a recent book, Harvard Professor Dani Rodrik (1997) suggests that trade affects not only the quantity of labour but its *elasticity* as well, which in turn has implications for real wages. He argues that globalization enables the services of large segments of the population, low-skilled workers and middle managers in particular, to be more easily substituted by the services of people in other countries. The consequence of increased instability in labour demand is greater instability in earnings and hours worked for such workers. It would also erode their bargaining power in setting the terms of employment. The author argues that this is an additional source of tension underlying the anxieties about globalization. As yet there is little evidence on the magnitudes of these effects.

A somewhat similar trade-based hypothesis is advanced by Bhagwati and Dehejia (1994) to explain increased differentials between skilled and less-skilled workers. The authors argue that increased economic integration and the rise of multinational enterprises have increased the volatility of comparative advantage – firms and industries have become more "footloose" as small shifts in costs can cause comparative advantage to shift suddenly from one country to another. Increased volatility in

comparative advantage leads, in turn, to increased labour turnover. Increased labour turnover reduces the relative wages of the lesser skilled, either because they have skills that are less easily transferable than those possessed by skilled workers or because they are less likely than high-skilled individuals to invest in skill upgrading during jobless spells. Zalkilwhal (2000) finds some empirical support for the Bhagwati-Dehejia hypothesis for Canada over the early 1990s.

Earnings inequality in Canada

The international debate over the impact of trade and technology on earnings inequality, particularly in the United States, has focussed on the declining relative employment and wages of low-skilled workers. In Canada, the debate regarding the sources of increase in earnings inequality is less clear.

Unlike in other countries such as the United States and the United Kingdom, the wages of high-skilled workers relative to low-skilled workers in Canada have not increased over the past 20 years or so.

While the demand for skilled workers has increased, the supply of educated workers has also increased significantly. According to some researchers (e.g. Murphy, Riddell and Romer, 1998), the stability in the skill premium merely reflects the fact that increases in the supply of skilled workers have offset the demand effects of skill-biased technological change. A similar story could apply to the effect of trade, but the Canadian literature has tended to focus on the technological change argument.

In Canada, wage differentials have arisen primarily between older and younger workers, and there is evidence suggesting that these differentials are not related to the effects of either trade or technology (e.g. Beaudry and Green, 1999). Factors identified in the literature as contributing to increased inequality

in Canada, particularly that between older and younger workers, include changes in labour market institutions such as minimum wages and unionization, changes in women's labour force participation patterns, and increased education among older workers.

There is still no consensus among researchers on the relative importance of these various factors, but explaining inequality trends in Canada is more than a matter of discriminating between the effects of trade and technology. More research is required to get at the sources of increased earnings inequality in Canada.

Foreign direct investment, employment and wages

It is often argued that the expansion of multinational enterprises (MNEs) has lowered the wages of workers in industrialized countries as they establish foreign affiliates and outsource jobs. Sometimes, the mere threat of outsourcing is seen as reducing domestic workers' bargaining power and holding their wages down. There is therefore a concern that lower wages in developing countries provide them with an unfair competitive advantage, thereby undermining employment prospects in industrialized countries.

According to recent reviews of the evidence by the OECD, the available research suggests that increased foreign investment and the outsourcing of production exert only moderate influences on labour markets in industrialized countries (OECD, 1994, 1998). Some of the main arguments advanced to support this view are as follows:

- Competitive advantage is driven by differences in unit labour costs and not necessarily by low wages. Low wages usually reflect low productivity, which generally results in there being much smaller differences in unit labour costs than those observed for wages.

- Like trade, foreign investment occurs mainly among OECD countries. As noted earlier, the United States and EU account for around 70 percent of Canada's outward direct investment flows.
- When investing outside the OECD, firms tend to invest in the richest markets, not the ones with the lowest wages. Moreover, evidence on the activities of U.S. MNEs shows that overall employment in their foreign affiliates actually fell between 1977 and 1994 (Lawrence, 1996, cited in OECD, 1998).
- The location decisions of firms are mainly determined by factors other than wages. These include proximity to suppliers and consumers, access to quality transportation and communications infrastructure, access to a skilled workforce, and a favourable legal environment for investors.

Policy Implications and Knowledge Gaps

In Canada's case, the evidence suggests that the importance of trade in explaining employment changes in both manufacturing and services sectors is increasing. There is little evidence that trade in general or the FTA in particular has led to large employment losses overall. Viewed over a long period, trade appears to have contributed positively to employment growth in Canada, particularly in high-technology, skill-intensive sectors. On the other hand, trade appears to have had a net negative impact on employment in low-technology, labour-intensive sectors, which employ relatively large numbers of low-skilled workers.

Exports are clearly an important source of jobs in the Canadian economy. With the expansion of world markets, policies that foster greater competitiveness of exports would contribute to the capacity of the Canadian economy to generate

jobs. At the same time, the import content of Canadian exports has risen significantly during the 1980s and 1990s, particularly in sectors where exports have risen the most. More needs to be known about the employment effects and resulting policy implications of this development.

The evidence also indicates that trade and investment behaviour of MNEs with respect to developing countries is likely to have more negative employment and wage impacts for low-skilled workers than high-skilled workers. However, the available evidence suggests that the magnitude of these effects is likely to be small. Although there is still disagreement among researchers, the evidence appears to favour technological change over trade as the main factor explaining the increasing demand for high-skilled relative to low-skilled workers. While the literature tends to treat trade and technology as separate factors, they are in reality complementary and interrelated processes. From a policy perspective, both trade and technology interact to increase the demand for high-skilled workers relative to the low-skilled. The main challenge for policy is how best to cope with this development and to ensure that the gains from trade are distributed more evenly.

Two main policy considerations arise in this respect. The first concerns the types of social protection policies required to facilitate the transition of displaced workers from shrinking sectors or firms to expanding ones. This involves developing the proper mix of "passive" income support schemes with appropriate work incentives and more "active" measures that assist the unemployed to compete successfully for new jobs (e.g. job placement services, training programs, job subsidies). Second, in the longer term, the pressures from globalization and technological change point to the need to upgrade the skills of the population so that workers are able to take better advantage of new opportunities and to adapt more easily to changing circumstances.

Pressures from trade are likely to continue as emerging, labour-abundant economies such China and India become more integrated in the world economy (OECD, 1997). Moreover, new technologies are increasingly available to developing countries and may enable them to compete more directly with developed countries in the future.

As a result, continued monitoring of the labour market effects of trade is warranted. Further assessment of alternative hypotheses on the labour market effects of trade such as those advanced by Bhagwati and Dehejia (1994), Zalkilwhal (2000) and Rodrik (1997) also constitute avenues for further research.

Finally, while trade with developing countries appears to have had a limited impact on the Canadian labour market in the aggregate, its impact obviously varies from one industry to another. Some industries are more exposed or sensitive to trade than others. Some may have particular characteristics (e.g. type of production technology) that interact with trade, resulting in sector-specific policy challenges. As a result, industry-level analyses are required to enhance the assessment of the impact of trade and its implications for adjustment in terms of employment and wages.

References

Baldwin, J., and M. Rafiquzzaman (1998). "The Effect of Technology and Trade on Wage Differentials between Nonproduction and Production Workers in Canadian Manufacturing," Statistics Canada, Analytical Studies Branch, Research Paper No. 98.

Baldwin, J., T. Gray and J. Johnson (1997). "Technology-Induced Wage Premia in Canadian Manufacturing Plants During the 1980s," Analytical Studies Branch, Statistics Canada, Research Paper No. 92.

Beaudry, P., and D. Green (1999). "Cohort Patterns in Canadian Earnings: Assessing the Role of Skill Premia in Inequality Trends," University of British Columbia, March 1999.

Bhagwati, J., and V. Dehejia (1994). "Free Trade and the Wages of the Unskilled – Is Marx Striking Again?" in J. Bhagwati and M.H. Kosters, eds., *Trade and Wages: Leveling Wages Down?* AIE Press, Washington, D.C.

Cameron, G., and P. Cross (1999). "The Importance of Exports to GDP and Jobs," Canadian Economic Observer, Statistics Canada, November 1999.

Dungan, Peter, and Steve Murphy (1999). "The Changing Industry and Skill Mix of Canada's International Trade," Perspectives on North American Free Trade Series, Paper No. 4, Industry Canada.

Gaston, N., and D. Trefler (1997). "The Labour Market Consequences of the Canada-U.S. Free Trade Agreement," *Canadian Journal of Economics*, Volume XXX, No. 1, February 1997.

Gera, S., W. Gu and Z. Lin (1999). "Technology and the Demand for Skills: An Industry-Level Analysis," Industry Canada, Working Paper No. 28.

Gera, S., and P. Massé (1996). "Employment Performance in the Knowledge-Based Economy," Industry Canada, Working Paper No. 14.

Gu, W., and L. Whewell (2000). "Trade Liberalization, Patterns of Trade and Productivity," Industry Canada, Working Paper, forthcoming.

Industry Canada (2000a). "Trade and Investment Monitor," Micro-Economic Policy Research Branch, Fall-Winter 2000.

Industry Canada (2000b). "Trends in Canada's Outward FDI: An Analysis of the New Database," Micro-Economic Policy Research Branch, July 2000.

Lavoie, M., and R. Roy (1998). "Employment in the Knowledge-Based Economy: A Growth Accounting Exercise for Canada," Applied Research Branch, HRDC, Research Paper No. R-98-E.

Lavoie, M., and P. Therrien (1999). "Employment Effects of Computerization, 1971-91," Applied Research Branch, HRDC, Working Paper, W-99-2E.

Lawrence, R.Z. (1996). *Single World, Divided Nations? International Trade and OECD Labor Markets*, Brookings Institution, Washington, DC, and OECD Development Centre, Paris.

Murphy, Kevin M., W. Craig Riddell and Paul M. Romer (1998). "Wages, Skills and Technology in the United States and Canada," NBER Working Paper No. W6638, July 1998.

OECD (1994). "Jobs Study: Evidence and Explanations," Chapter 3, Paris.

OECD (1995). "Foreign Direct Investment, Trade and Employment," Paris.

OECD (1996). "Trade, Employment and Labour Standards: A Study of Core Workers' Rights and International Trade," Paris.

OECD (1997). "Employment Outlook," Chapter 4, Paris.

OECD (1998). "Open Markets Matter: The Benefits of Trade and Investment Liberalization," Paris.

OECD (2000). "An Update of the 1996 Study: Trade, Employment and Labour Standards: A Study of Core Workers' Rights and International Trade," forthcoming.

Rodrik, D. (1997). *Has Globalization Gone Too Far?* Institute for International Economics, Washington, D.C.

Schwanen, D. (1997). "Trading Up: The Impact of Increased Continental Integration on Trade, Investments and Jobs in Canada," C.D. Howe Institute Commentary No. 89.

Trefler, D. (1999). "The Long and the Short of the Canada-U.S. Free-Trade Agreement," Industry Canada, Perspectives on North-American Free Trade Series, Working Paper, No. 6.

Zalkilwhal, O. (2000). "Trade and Wages: A Non-Stolper-Samuelson Explanation – Evidence from Canada," Ph.D. dissertation, Department of Economics, Carleton University, Ottawa.

Part III

Implications for Trade Policy



The Case for a New Round: Has It Been Made?

Dan Ciuriak
Senior Economic Advisor
Trade and Economic Policy and Trade Litigation
Department of Foreign Affairs and International Trade

This paper was prepared for the 2000 National Policy Research Conference. The paper draws heavily on the results of research papers prepared for, and seminar discussions held under the aegis of, the interdepartmental Working Group on World Trade Issues constituted under the Global Challenges and Opportunities Network (GCON). The paper also draws heavily on discussions held at the Department of Foreign Affairs and International Trade over the course of 2000, which were enriched by the participation of several of the leading scholars on international trade, and on some of the new trade policy literature that emerged during the course of 2000. The views expressed in this paper are those of the author; errors of interpretation or fact are the sole responsibility of the author as well. The usual disclaimer in respect of research prepared in a personal capacity by those in the public service also obtains: the views expressed are not to be attributed to the Department of Foreign Affairs and International Trade or to the Government of Canada.

Introduction and Overview

It is now exactly a year since the failed World Trade Organization (WTO) Ministerial meeting in Seattle. The past 12 months have afforded ample opportunity for post mortems and stocktaking, debate and research, and the synthesis of new views. Where does all of this leave trade policy?

First, there remains more or less general agreement within the trade policy community on the answers to the free trader's fundamental catechism:

- Is trade necessary for growth and development? Yes.
- Is opening up to trade *sufficient* for these ends? No – sound macro-, micro- and mezzo-economic policies, proper sequencing of reforms, and good governance broadly writ are also necessary.[1]
- Is the multilateral system working? Yes.
- Are there nonetheless further gains to be had from further liberalization? Yes.
- Do these gains have to be better distributed within domestic economies and between North and South? Yes.
- Do the developing countries need help to access these gains? Yes.
- Are reforms needed to the multilateral institutions and the WTO in particular to achieve these goals? Yes.

All this being said, the way ahead is not entirely clear. There is disagreement as to how far and how fast to go, and some would even argue that globalization has gone too far already. To some extent, there are even questions as to which direction to take as there is currency to the view that some of the new directions taken in the Uruguay Round represent missteps. Moreover, some believe that regional agreements offer greater opportunities than the multilateral route.[2] Finally, what might be

---

[1] This is often referred to as the "Washington Consensus," which is not really a consensus, at least outside the circle of governments.

[2] The general view of preferential regional trading arrangements has been that their trade-creating and other beneficial aspects dominate the trade diversion to which they give rise. Indeed, a recent study suggests that the regional route to free trade might actually lead to larger welfare gains than the multilateral route because the regional pact might offer greater incentives for firms to incur the large fixed costs in terms of distribution and marketing required to enter the export market in the first place. See Caroline Freund, "Different Paths to Free Trade: The Gains from Regionalism," *The Quarterly Journal of Economics*, Vol. CXV, No. 4, November 2000. At the same time, criticisms have been levelled at regional initiatives because of the proliferation of rules of origin, which generate not insignificant costs of compliance; moreover, in some cases, such as the United States, Africa and

termed the mainstream view is held with less conviction than it was pre-Seattle. This is significant in and of itself because, unlike the situation following previous failed Ministerials, which foundered on questions of content and pace, the Seattle Ministerial collapsed on questions of the desirability, as well as content and pace, of future liberalization.[3] In short, the case for a new round has implicitly been called into question.

This paper addresses this issue. First, it considers the evidence for further gains from trade. Since these gains appear to depend to an important extent on the integration of developing countries into the trading system, the paper addresses the likelihood of this being achieved.

Gains from Further Liberalization

An important preliminary question is: What is at stake in economic terms from further liberalization? On the face of it, despite the enormous growth in trade and investment over the past half century,[4] the evidence of a very strong "home bias" in

---

Caribbean Bill, it has been argued that the distortions may well outweigh the trade creation.

[3] This argument is advanced by W.A. Dymond and M.M. Hart, "Post-Modern Trade Policy: Reflections on the Challenges to Multilateral Trade Negotiations after Seattle," *Journal of World Trade* 34(3): 21-38, 2000.

[4] Merchandise exports are currently at about 25 percent of global GDP, with cross-border trade in services at about 7 percent. Meanwhile, the value of sales by foreign affiliates of multinational companies now is roughly equal to cross-border trade in the case of merchandise and is well over one and one half times the value of cross-border trade in services. Adding these together, total exports of goods and services, defined in this broad manner, would appear to be in the order of two thirds of global GDP, with imports, of course, accounting for a similar share. For a discussion, see J.M. Curtis, "Trade and Civil Society: Toward Greater Transparency in the Policy Process," in J.M. Curtis (ed.), *Trade Policy Research 2001,* Department of Foreign Affairs and International Trade, 2001. The degree of openness varies widely by country, with the world's largest and arguably most highly developed economies – the United States and Japan – being among the least "open" (as measured by the sum of cross-border imports and exports divided

trade and investment suggests that there remains considerable scope for additional expansion of trade.[5] Jeff Frankel recently summarized the current understanding, based on so-called "gravity models" of international trade, of the trade-inhibiting effects of various factors as follows:[6]

- *Borders:* two firms located on opposite sides of a national border trade two thirds less than if they were located in the same country.[7]

---

by GDP), and small highly developed economies such as the Netherlands and Canada being among the most open. What is of particular interest is that, measured by cross-border trade as a percentage of GDP alone, the United States is not much more "open" than it was a century earlier and Japan is actually less "open" on that basis than it was a hundred years earlier. At the same time, the United States is generally considered to amongst the most "open" economies in terms of ease of entry, while Japan is thought to be amongst the least open in this sense. These observations emphasize that caution is warranted in drawing conclusions about the linkage between trade policy and measured openness or the scope to expand trade (since expansion of the internal market and/or decline in price differentials internationally may reduce the incentive to seek markets beyond national borders).

[5] For a discussion of home bias and related empirical puzzles in international trade and investment, see M. Obstfeld and K. Rogoff, "The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?" *NBER Macroeconomics Annual 2000* (forthcoming).

[6] J. Frankel, "Assessing the Efficiency Gain from Further Liberalization," paper delivered at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium*, Harvard University (June 1-2, 2000). This paper is available online (http://www.ksg.harvard.edu/cbg/trade/frankel.htm).

[7] This estimate of the size of the border effect is not directly comparable to others cited in some of the literature since it is net of common currency and other effects. John Helliwell estimates the border effect for Canada-U.S. at 10-12 for merchandise trade and for services at over 30. He also cites estimates for the European Union at between 6 and 19 and for other OECD countries at 10 or more. For developing countries, the border effects are much larger. See J.F. Helliwell, *Globalization: Myths, Fact and Consequences*, Benefactors Lecture, 2000, C.D. Howe Institute, October 2000.

- *Distance:* if two countries are not adjacent, trade falls by half, with a further 1 percent decline in trade for each 1 percent increase in distance between them.[8]
- *Currencies:* use of different currencies (even if fixed exchange rates are used) reduces trade by two thirds, with a further 13 percent reduction due to exchange rate variability.[9]
- *Culture:* if two countries speak different languages, trade falls by half.
- *Trade rules:* if two countries do not belong to a free trade area, trade falls by two thirds – and even further if the tariff and non-tariff barriers are at the heights typically found in developing countries.

Even ignoring completely the pure effects of distance and formal trade barriers, these various factors would reduce, for most country pairs, the likelihood of an international transaction taking place between two firms to less than 5 percent of that of a domestic transaction. Add in distance and trade barriers, and the likelihood falls to something on the order of 1 percent.

Most of these factors cannot be addressed through the WTO or multilateral negotiations. Moreover, those that can account for only a tiny fraction of the overall extent of inhibition of trade.[10] Nonetheless, these gains are not to be sneered at.

---

[8] Helliwell puts the distance elasticity at 1.5. See J.F. Helliwell, ibid.

[9] A recent study by Andrew Rose found the smallest point estimate of the expansion of trade within a common currency zone to be 285 percent, and most were larger. See A. Rose, "Common Currency Areas in Practice," paper presented at the Bank of Canada seminar *Revisitng the Case for Flexible Exchange Rates*, November 1, 2000. The estimate cited by Frankel is thus on the conservative side. There are important questions surrounding Rose's findings (e.g. whether the direction of causality runs from strong trade linkage to common currencies and whether the results can be generalized from a rather unrepresentative sample of countries); however, for the purposes here the point is moot since anything not explained by common currencies would have to be added back into the general and otherwise unexplained "border" effect.

[10] Helliwell argues that the explanation for the very high border effects rests on the extent of networks of association and trust. These are developed

Several recent econometric estimates suggest trade expansion on the order of 20 percent could be leveraged by a new round,[11] with significant gains implied for real GDP: static efficiency gains would amount to between 1 to 1.5 percent of global income[12] with additional dynamic gains driven by the expansion of trade on the order of 6.5 percent,[13] for a total of perhaps 7.5 to 8 percent additional global GDP – in the ballpark of US$2.25

---

through a multitude of means but importantly include things like casual contact, which happens frequently only in a restricted locale. This argument recalls, of course, Robert Putnam's thesis concerning the importance of informal institutions such as bowling leagues and choirs – social capital in general terms – to good economic performance. See R. Putnam, "Bowling Alone: America's Declining Social Capital," *Journal of Democracy* 6:1, January 1995, 65-78.

[11] Based on results obtained by T. Hertel, "Potential Gains from Reducing Trade Barriers in Manufacturing, Services and Agriculture," 24th Annual Economic Policy Conference, Federal Reserve Bank of St. Louis, Oct. 21-22, 1999.

[12] This range is suggested by the following estimates: Hertel (1999): US$350 billion, with the major contributions obtaining from liberalization of agriculture, manufacturing and services, in that order. Nagarajan (1999): US$400 billion, or 1.4 percent of global income, with the gains obtaining from trade facilitation and across-the-board tariff reduction; plus an additional US$85 billion from an agreement on competition (interestingly, Nagarajan models trade facilitation as a reduction in transport costs, a technique pioneered by Japan in its 1997 Asia-Pacific Economic Cooperation Economic Committee study on the gains from APEC's Trade and Investment Liberalization and Facilitation program). Dee and Hanslow (2000): US$260 billion, of which $130 billion comes from services, $80 billion from manufactures and only $50 billion from agriculture. Dee and Hanslow factor in foreign direct investment effects in their study. See P. Dee and K. Hanslow, "Multilateral Liberalisation of Services Trade," Productivity Commission Staff Research Paper, Ausinfo, Canberra (2000); T. Hertel, "Potential Gains from Reducing Trade Barriers in Manufacturing, Services and Agriculture," op. cit.; N. Nagarajan, "The Millennium Round: An Economic Appraisal," Economic Papers No. 139, European Commission, DG for Economic and Financial Affairs, November 1999.

[13] This is based on the commonly used rule of thumb that a one percentage point gain in trade leverages one third of a percentage point growth in income.

to $2.4 trillion, or two good years of global growth at the present level of global income, spread over several decades.[14]

While the gains that can be obtained through a multilateral round are considerable in gross terms, several considerations suggest that the net gains are likely quite substantially smaller.

First, these gains are not net of frictional adjustment costs. Insofar as liberalization changes the economic parameters under which existing investment was put in place, it leads to early write-down of investment, a dead-weight loss that needs to be subtracted from the efficiency gains made elsewhere.

Second, the gains are not net of risks of destabilization. For example, since potential income is depressed during downturns by the decrease in investment during the downturn, an episode of balance of payments instability as a country adjusts to new competitive pressures and consumption patterns under freer trade could easily wipe out gains from liberalized trade for some years. While the risks of instability associated with trade are more likely to come from disruption of existing trade than exposure to new trade, one cannot entirely discount the risk of opening up, especially to previously highly sheltered economies such as transition economies. At the same time, other policies associated with openness to trade (or put in place to facilitate trade) can lead to instability. Korea's experience with capital account liberalization, which was required for it to become part of the Organization for Economic Co-operation and Development (OECD), and Mexico's commitment to a strong

[14] By comparison, Frankel uses Hertel's $350 billion estimate for the static efficiency gains from a new round and then, based on the 20 percent expansion of trade in Hertel's model, estimates a further 2 percent increase in global income from the dynamic gains realized over 30 years and an 8 percent increase in the "truly long run." Accordingly, the gains (in terms of permanent income levels) from a new round could be quantified at about 3.2 percent of current global income, or close to US$1 trillion, to be realized fully only in 30 years, and nearly triple that in the "truly long run." See J. Frankel, "Assessing the Efficiency Gain from Further Liberalization," op. cit.

exchange rate as an external anchor for a policy package centred on trade liberalization are cases in point.[15]

Third, the effects of trade expansion on the environment are not taken into account – which, it should be noted, is not through disregard but because the accounting is extremely complex and quantification well nigh impossible.[16]

---

[15] As a practical matter, adjustment can take years and downturns can be very deep. For example, for much of the 1990s it was hard to distinguish Russia's structural adjustment from an economic death spiral. However, even if countries have rapid recoveries, which was the case in both Mexico and Korea, both of which had V-shaped recoveries in real terms, exchange rates may remain well below pre-crisis levels (as has been true for both Mexico and Korea), reducing their gains from liberalization measured in U.S.-dollar terms, which arguably is the relevant measure since what matters in trade is what a country can afford to buy on the international market. It could be argued that such risks are already taken into account in the estimates of gains from trade obtained using econometric models in that parameter estimates of the expansion of trade and incomes leveraged by trade liberalization represent averages that summarize a wide range of experiences of individual countries in varying historical circumstances. The gains from future liberalization should similarly be interpreted as averages that would reflect some very positive experiences, some average responses, and some isolated failures due to macroeconomic destabilization that might be due to liberalization. By the same token, it might be argued that these risks are higher for relatively isolated developing countries that are latecomers to an already highly developed and competitive trading system; accordingly, the historical experience of the countries that currently account for the bulk of trade and whose histories therefore dominate parameter estimates might tend to actually understate the true risk.

[16] While this issue is addressed later in the paper, a few words are nonetheless in order here as the context is somewhat different. For one thing, there is a time dimension to these effects in the form of an "environmental Kuznets curve," which links longer-term environmental improvements to growth after an initial stage where economic activity increases pollution, greenhouse gases and so forth.

There are also various pluses and minuses: trade agreements can limit environmentally damaging subsidies to agriculture, forestry and coal but also intensify pressures on the global commons. In addressing this latter issue, Frankel notes that "It is difficult to imagine…that trade is anything but bad for the survival of tropical hardwood forests." See J. Frankel, "Assessing the Efficiency Gain from Further Liberalization," op. cit.

Fourth, applying discount rates to reflect the time value of money substantially reduces the gains 20 or 30 years hence and makes the gains that are only achievable in the truly long run of little practical consequence in decisions taken today. Not only are these benefits too far off to figure practically in political economy calculations, but they are based on the assumption of no change in the underlying economic structures and relationships, which is almost certainly false.

Fifth, for public policy the relevant question is how best to deploy scarce resources – whether to advance trade negotiations or advance other policy goals – which is a question of *relative* legitimacy.[17] Taking into account the heavy lifting required to expand the trade share of GDP through trade negotiations, the fact that technology is the main driver of growth and development, with trade but a supplementary factor,[18] and the limited resources in the jurisdictions that stand to gain most from trade, the opportunity costs of pursuing a multilateral round are significant and need to be reflected in the cost-benefit analysis.

Sixth, the case has been made, by John Helliwell, that the relationship between income gains and trade expansion is non-linear – income gains from trade expansion face eventually diminishing returns. In other words, a country going from 0 to 10 percent in terms of trade share in GDP would benefit much more from trade than a country like Canada going from 85 to 95 percent. Insofar as the major part of the gains do in fact obtain at the earlier phases of opening up, most of the trade gains from a new round would have to be generated in the

---

[17] This observation was made by Pierre Jacquet of the Institut Français des Relations Internationales at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium*, Harvard University (June 1-2, 2000).

[18] See, for example, arguments to this effect in J. Sachs, "A New Framework for Globalization," paper delivered at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium*, Harvard University (June 1-2, 2000).

developing countries to validate the estimate of income generated thereby.

At the end of the day, a convincing case for the gains from further liberalization remains to be made. The empirical evidence suggests that large gains could potentially be realized in gross terms; however, there are questions about the assumptions on which these estimates are based. Moreover, public policy should be based on an estimate of the gains expressed in net present value terms with account taken of opportunity costs. This accounting remains to be done, but the expectation would be for a much reduced figure: (a) the various costs and risks associated with liberalization (adjustment costs, risk of macroeconomic instability and collateral environmental damage) tend to be front-end loaded, while the benefits are spread over several decades, with the more distant benefits subject to deep discounting in present value terms; and (b) given that trade ranks clearly second to technology as a driver of growth, the use of scarce public resources (particularly in the developing countries) for trade negotiations raises potentially significant opportunity costs. In short, the intellectual basis for a new multilateral round remains in question.

Trade and Development

If the bulk of the estimated gains from further trade liberalization are to come from bringing marginalized developing countries more fully into the multilateral trade system, what can be said about the likelihood that these gains will actually be realized? This involves several related questions: Will the developing countries engage in a new round? Will they be able to take advantage of the market opening thereby achieved to become more fully integrated into the international trading system? Will the additional trade in fact lead to growth and development? These questions are taken up in turn.

Will the developing countries engage in a new round?

This issue has been directly addressed by Jagdish Bhagwati.[19] His main thesis might be summarized as follows:

1. The uneven distribution of benefits from the Uruguay Round needs rebalancing through improved market access in key traditional areas of developing-country interest.
2. At the same time, developing countries need to genuinely buy into liberalization, as there is no "free lunch" in a system driven by the exchange of benefits – nothing offered, nothing gained.
3. Most of the "trade and..." issues (in his terms, the "trade-unrelated" issues) need to be kept on the back burner (e.g. competition policy) or clearly hived off for treatment elsewhere (e.g. labour); however, developing countries need to engage on the trade and environment issue.[20]
4. Go easy on the tempo; allow time for full implementation and adaptation to the changes engendered by the Uruguay Round.
5. On institutional and governance issues, there are three points of interest:
   - The current asymmetry between developed and developing countries in terms of power and influence in negotiations requires institutional reforms (including the "green room" process).

---

[19] See J. Bhagwati, "What It Will Take to Get Developing Countries into a New Round of Multilateral Trade Negotiations," in J.M. Curtis (ed.), *Trade Policy Research 2001*, op. cit.

[20] Interestingly, another eminent trade policy commentator, Gary Hufbauer, argues that *both* labour and the environment are poison pills for the objective of getting developing countries into a new round. See G. Hufbauer, "Trade and Coherence: Where the Major Gains Lie," in J.M. Curtis (ed.), *Trade Policy Research 2001*, op. cit.

- The positions of civil society organizations (CSOs) are threatening to developing countries, and bounds on CSO influence accordingly need to be set.
- Cross-conditionality cannot be allowed either formally or through the back door as part of the "coherence" agenda being pursued by the international agencies.

Comparing the current state of play to the position laid out above, the following observations can be made. First, there has been little if any movement on the central bargaining issues between the developed and developing countries, namely agriculture and textiles.[21]

Second, the emerging evidence on growth in trade since Marrakech, which has been disproportionately in favour of the developed countries, can only serve to reinforce the view of many developing countries that they were "short-changed" in the Uruguay Round.[22]

Third, there remains a clear and deep conflict between the developed and developing country positions on the nature of a new round. The developed countries (read the United States and European Union) want to broaden the scope of trade rules. A year after Seattle, when this divide was thrown into sharp relief, it has, if anything, gotten wider as the United States has in its free trade agreement with Jordan and rhetorically staked out the

---

[21] The recent survey of the trade scene by *The Economist* struck a relatively pessimistic tone on these issues. With regard to agricultural subsidies, it had this to say: "The WTO is determined to eliminate export subsidies throughout its membership, but try telling that to the House of Representatives – or to the French government. Frustration with rich countries' intransigence reaches from grass-roots protesters in Seattle and Prague all the way to the top; even [WTO Director-General] Mr. Moore bemoans the snail's pace at which America and Europe have implemented reforms to their markets for agricultural products and textiles. 'Sometimes I feel like the joining the kids outside' he says. 'When they say the system's unfair, they're not always wrong.'" See "The Trade Agenda," *The Economist,* November 11, 2000, p. 85.

[22] See *The Economist*, ibid., pp. 83-84.

position that it intends to introduce labour and environmental standards into any future trade agreement.

Fourth, the conventional wisdom emerging from the Asian Crisis on the need for appropriate "sequencing" of reforms supports if anything a more cautious approach rather than putting wind in the sails of reformers bent on liberalization.

Finally, while the institutional governance issues seem to admit the possibility of compromise in the form of trade-offs amongst various conflicting interests, there is no obvious answer to the question of how such a compromise could be brokered. The WTO lacks an executive council that could put its weight behind a proposal; and the very fact of a divided term for the Director-General indicates that neither current Director-General Mike Moore nor his successor-in-waiting, Thailand's Supachai Panitchpakdi, had sufficient broad-based support within both the developed and developing country blocs to give him a strong personal hand as a deal maker.

The above observations provide no grounds for optimism that developing countries will join a new round any time soon. This conclusion is actually reinforced if one examines carefully one of the main arguments raised in rebuttal to this conclusion: since accession to the WTO is more or less equivalent to a belated buy-in to the Uruguay Round, how can one explain the fact that so many developing countries outside the WTO are lined up to get in?

There is something to this point in terms of tempering criticisms of the *lack* of Uruguay Round benefits for developing countries; however, it does not necessarily temper criticisms based on an *imbalance* of benefits, nor does it say anything in particular concerning the likely attitude of developing countries toward *further* liberalization once they have achieved membership. Asymmetry in bargaining power is real in the global trading system; the question for smaller members is whether it is better to deal with the asymmetry up front, in an accession negotiation, versus potentially in the heat of a live

trade dispute with one of the major economies.[23] A risk evaluation could well lead to a rational decision to join the WTO as soon as possible even if the immediate benefits are small (or even negative). Once inside, however, with the insurance against unilateral trade actions safely in hand (i.e. having neutralized the asymmetry of power in the *application* of trade rules), there may be no further incentives for liberalization – which involves facing yet again the asymmetry of power at the negotiating phase. Moreover, given the fact that the WTO moves on the basis of consensus, membership gives even small countries in effect a veto over forward movement that is not in their interest. This would suggest that the Uruguay Round was not such a bad deal for developing countries while at the same time pointing to a potentially serious miscalculation on the part of any who may believe that getting developing countries into the multilateral system was a prelude to deeper liberalization.[24]

---

[23] In this regard, consider Sylvia Ostry's description of the U.S. threat of trade sanctions in pressuring developing countries to accept a deal on intellectual property rights. As she explains, "a new Special 301 of the 1988 Trade and Competitiveness Act was targeted at developing countries with inadequate intellectual property standards and enforcement procedures. As the Uruguay Round negotiations proceeded, the message in Brasilia and new Delhi [the leaders of a group of developing countries resisting the inclusion of the "new trade policy issues" in the round] became clearer: given a choice between American sanctions or a negotiated multilateral arrangement an agreement on TRIPS began to look better." See S. Ostry, "The Uruguay Round North-South Grand Bargain: Implications for Future Negotiations," paper delivered at the conference *The Political Economy of International Trade Law*, University of Minnesota, September 2000.

[24] Moreover, it suggests that, absent willingness on the part of the United States and European Union to underwrite multilateral liberalization by eschewing to exercise their clout in negotiations, the only way to move forward on trade policy in the future might be through legal activism on the part of the dispute settlement body, an issue that will be addressed later.

This issue is taken up by CIDA's Kerry Max.[25] Reflecting the broad consensus on the role of trade in development, Max makes several key assumptions concerning this relationship:

1. Trade liberalization can foster economic growth.
2. Economic growth is essential for poverty reduction.
3. Economic growth, though essential, is insufficient for poverty reduction, with other key needs being threefold:
   - the technical and legal implementation capacity to address WTO rights and obligations;
   - private sector development; and
   - an enabling environment in the form of governance, infrastructure and policies which are essential to the ability of both domestic and international firms to translate opportunities from trade into viable economic activities.[26]

Max then draws the connection between trade-led growth and poverty reduction, noting that this too depends on private sector development and an appropriate enabling environment.[27]

---

[25] See K.D. Max, "Addressing Trade-Related Development Needs: Options for the Donor Community," in J.M. Curtis (ed.), *Trade Policy Research 2001*, op. cit.

[26] These assumptions closely parallel the so-called "Washington Consensus" view that there is a connection between openness and the dynamism of an economy, but a coherent policy framework (market-oriented domestic policies and good governance, including enforcement of contracts, protection of property rights, etc.) and some basic conditions (macroeconomic stability) are required in addition to having an open trade and investment regime, to ensure eventual convergence with OECD-level incomes. Since the Washington Consensus is applied loosely both to marginalized countries (as a prescription for exiting that condition) and to open but poor countries (as a way to take advantage of trade), it is not so much a causal theory about the role of trade or other factors in development as a general observation concerning the characteristics of successful countries.

[27] Recognizing that growth does not necessarily benefit all the poor (and indeed in some cases some of the poor may wind up poorer still – even in the long run), Max also identifies a third category of poverty reduction-targeted

Based on these assumptions, Max then considers how best the international community can support developing countries in their development ambitions and recommends a basic division of labour, with the WTO addressing the delivery of all WTO membership-specific needs (i.e. substantial trade-related technical assistance), and the donor community (including the international agencies) addressing the remaining categories of private sector development, enabling environment and poverty-targeted interventions.

What is most important in this analysis is that it identifies the need for a very substantial *increase* in support in both respects if developing countries are to be able to take advantage of liberalization.

It is well beyond the scope of this survey to consider the adequacy of the international development assistance in general or even of the trade-related component alone. Suffice it to note that there is a question of scale to be addressed. A substantial increase in support cannot be mobilized quickly, even if the political will were there and the resources were available. And the decision to commit resources has not yet been made, at least in an order of magnitude that would be clearly seen as making the difference.[28]

There is also a more fundamental question of whether getting the effective trade and supporting policies in place is in fact the answer to getting the marginalized developing countries firmly established in the trading system. A recent careful analysis of the literature by Francisco Rodriguez and

---

interventions to address the unmet basic needs of those marginalized from economic activity or unable to meet their needs based on current economic participation. See K.D. Max, op. cit.

[28] The World Trade Organization has a total of only 29 staff in its Development and Technical Co-operation Divisions combined. World Trade Organization, *Annual Report 2000,* p. 104. The WTO budget is generally considered totally inadequate to the task, and the Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries, which was supposed to compensate for lack of WTO resources, has been ineffective. Max also comments on the past failures by developed countries to deliver promised technical assistance.

Dani Rodrik concludes that there is no evidence that an open orientation of trade *policy* reliably leads to growth. They argue that previous studies that had found such a relationship involved mis-specified equations in which trade openness served as a proxy for other variables (such as geography). When these other variables are included (e.g. distance from the equator), the significance of the trade openness variable vanishes. While they caution that this is not to argue that being closed to trade is a good idea, they do emphasize that there is no basis for strong conclusions about the ability to expand the trade of isolated countries by reducing policy-induced trade barriers.[29]

These observations point to two general conclusions. First, assistance in implementing trade and supporting economic policies may have little impact in the currently marginalized countries. Second, the analytical results need to be revisited to determine whether or not the trade expansion estimated to obtain from a new round of trade liberalization is overstated.[30]

---

[29] See R. Rodriguez and D. Rodrik, *Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence,* May 2000 (http://ksghome.harvard.edu/~.drodrik.academic.ksg/papers.html). A similar conclusion is reached by Dan Ben-David, who notes: "it is far from obvious (at least to this author) that the impact of trade liberalisation found on incomes in the middle and high income countries could also be found in the poorest countries in the world." Dan Ben-David, "Trade, Income Disparity and Poverty," World Trade Organization, Special Studies 5, p. 39.

[30] General equilibrium models estimate the trade expansion from liberalization based on differences in factor intensities and prices in the various economic jurisdictions. Apart from transportation cost margins, they make no formal distinction between the potential for gains from trade between countries based on geographic separation or cultural and linguistic differences (although these factors are captured to some extent in the initial conditions as to the intensity of trade between two given countries built into the data set; these silently proxy the gravity effects in that, if bilateral trade is minimal, then changes in factor prices, etc., result in quantitatively insignificant effects – I am indebted to Konstantin Loukine for this point). This issue appears to be related to the question of the "missing trade" (which refers to trade "missing" compared to predictions of standard Heckscher-Ohlin trade theory), as discussed in D. Trefler, "The Case of the Missing Trade and Other Mysteries," *American Economic Review* 85 (5): 1029-1046.

Will the additional trade in fact lead to growth and development?

Finally, there is the question of whether currently marginalized developing countries could leverage expanded trade into development, even if they were able to expand their trade substantially.[31] This is important in view of the diminishing returns argument discussed earlier, which suggests that the income gains from further trade expansion on the part of the developed countries would be comparatively modest.

There is a presumption that the answer to this question is "yes," given the overall strong positive correlation between trade and growth and between economic growth and increases in income of the poorest.[32] Moreover, it can be observed that the only countries that have "taken off" in a development sense have been trade-oriented; conversely, no country that has chosen an isolationist or self-sufficiency policy has proved successful in this sense.[33]

Generally speaking, the decline in trade with distance is thought to exceed by far what could be accounted for by transportation costs alone.

[31] Note: this is a somewhat different question from what it takes to avoid marginalization – countries that are already quite open are by definition trading and not "marginalized" in that sense.

[32] Gary Hufbauer makes this point. Hufbauer also notes that, unlike the case of trade and growth, the linkage between FDI and growth is equivocal. This is somewhat curious since the causal relationship between capital accumulation and technology and growth is actually empirically better established than is the relationship between trade and growth. See G. Hufbauer, op. cit.

[33] Dani Rodrik has argued that this may not be the fault of the import replacement policies adopted by countries that have gone this route but accompanying poor macroeconomic or financial policies. While plausible, this argument is not powerful as it calls for a major selection bias (i.e. only poorly managed countries choose import replacement) and thus plays into the hands of the counter argument advanced by some that openness to trade effectively constrains bad policies and/or outcomes (e.g. through external

However, there are also countries that have not developed nearly as well as might be expected, given their degree of openness, and others that have done much better than their degree of openness would imply. This calls into question whether the observed correlation involves causation flowing from trade to growth (versus, say, from growth stimulated by third factors to trade).[34]

There are other troubling facts from an analytical perspective. Some work by Andrew Rose shows that common currencies result in at least a threefold increase in trade, significant specialization among the trading partners and also improved inflation performance. Strikingly, while many of the countries in the sample were rich, many were also poor. What this indicates is that even if there is trade and international specialization of production, there is not necessarily development.

Jeff Sachs offers an explanation for these anomalies based on the influence of geography on trade and economic performance. He holds that countries can be sorted roughly into three categories:

- a "technological first world of innovators," countries that produced at least 10 U.S. patents per million citizens in 1997;
- a second world of "technological adopters" (identified as countries that attract significant amounts of foreign direct investment in high-tech sectors and have at least some exports to first-world markets in high-tech

---

commitments to market-friendly policies in order to attract investment and disciplines of international competition on domestic industries).

[34] Alan Winters has this to say on the subject of causation in the relationship between trade and growth and foreign direct investment and growth: "In both cases the problem is one of causation: efficiency and exports are linked because efficient firms export, FDI and efficiency because investors choose efficient firms and sectors." See L. Alan Winters, "Trade and Poverty: Is There a Connection?" World Trade Organization, Special Studies 5.

sectors), which tend to be clustered around the technological innovators; and

- the rest of the world, which is described as "technologically stagnant" and which tends to be geographically more distant from the technological innovators. These areas include southern Mexico and pockets of tropical Central America, the Andean countries, most of tropical Brazil, tropical sub-Saharan Africa, most of the former Soviet Union aside from the areas nearest to European and Asian markets, and landlocked parts of Asia such as the Ganges Valley states of India, landlocked Laos and Cambodia, and the far-interior regions of China.[35]

If, as is suggested by the conventional wisdom, good governance and sound economic policies determine growth and development, why should the technology content of exports and FDI and regional location be so significant? Sachs suggests that the root cause of underdevelopment is actually collapsing social structures due to disease;[36] and/or reliance on primary commodities, which are continuously being "innovated against" and hence face a long-term decline in terms of trade that makes them a very weak basis for development. Indeed, insofar as liberalization of agriculture and textiles would tend to reinforce specialization in commodities, it could even be harmful to the long-term development interests of these countries.

---

[35] See J.D. Sachs, "A New Framework for Globalization," paper delivered at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium*, Harvard University (June 1-2, 2000).

[36] This is particularly the problem for sub-Saharan Africa, which is ravaged by AIDS and other diseases incubated in the tropics. While the spread of AIDS has prompted massive investment in medical research in the industrialized countries, tropical diseases have generally not received much attention, as there is no profit prospect for Western pharmaceutical firms.

Where does the trade and development issue then stand?

With the trade and development debate up in the air, it is worth recalling past shifts in intellectual fashion on this point. In a recent article, Joe Francois draws attention to Harry Johnson's 1977 review of the state of thinking on trade and development. Francois notes that Johnson saw intellectual cycles moving between rejection and embrace of the world trading system "...with a strong bias toward the former. In looking toward the future, Johnson saw development economists placing renewed emphasis on commodity price stabilisation and monopoly trading schemes along the lines of OPEC." Francois goes on to note that things worked out very differently as "Outward oriented policies emerged as a consensus policy in the 1980s."[37]

Such shifts in conventional wisdom reflect the presence of significant "outliers" in the data. East Asian economies such as Korea and Taiwan were the outliers in the late 1970s that forced a change in the conventional wisdom of that age. There are other outliers today that call into question today's conventional wisdom, which is based largely on East Asia's experience: "On the positive side, the South East Asian economies, together with Mauritius and Chile, are good deviants. At the same time, the bad deviants include Zambia, Gabon, and Haiti."[38]

Accordingly, the mere presence of doubt regarding the linkages between trade and growth and development does not remove the very strong presumption in favour of trade. This judgement is reinforced by the evidence reported by John Helliwell that border effects are higher for R&D spillovers than for trade, and that distance matters as well.[39] If technology is the key to development, then trade may be the best source of a supplementary boost to developing countries' own efforts to develop an indigenous knowledge-generating culture.

---

[37] See Joseph F. Francois, *The International Economy and Economic Development* (Francois' website, 2000).

[38] See Joseph F. Francois, ibid., p. 7.

[39] See Helliwell, op. cit., p. 35.

However, the weight of the overall evidence does caution against overselling trade as a reliable route to development. It also cautions against counting the global gains from trade as being in the bank, if those gains depend heavily on countries that are at present marginalized, without a better understanding of why they are marginalized.

Some Tentative Conclusions

The discussion above suggests that a robust case for a new round of multilateral negotiations has not yet been firmly established on analytical grounds.

- While there is still considerable untapped potential to expand trade, a number of important questions have been raised as to whether, and under what conditions, this would translate into income and welfare gains sufficient to warrant the commitment of scarce policy resources at this time.
- Moreover, insofar as the income and welfare gains from a new round would depend heavily on the integration of currently marginalized developing countries into the trade system, the discussion of "trade and development" suggests that there are simply no grounds for optimism that these gains could be realized except in the longer term and subject to considerable improvement of so-called "enabling conditions."

However, this does not necessarily leave the trade system in bad shape, or its policy making necessarily in hiatus – quite the contrary. Accession of China, Taiwan and the states of the former Soviet Union alone would generate benefits of the same order of magnitude as a new round, and with fewer of the caveats that attach to getting developing countries in general into the trading system. The development of case law by the Dispute Settlement Body is pushing the envelope both on implementation of commitments and the refinement of WTO law itself. And incremental changes to the institutional framework are well suited to a Ministerial meeting process. At

the same time, this affords a window of opportunity to develop the intellectual basis for further liberalization and for the direction to take in further developing the architecture of the multilateral system, and dealing with the WTO's governance issues.

The "Trade and..." Agenda: Are We at a Crossroads?

Dan Ciuriak
Senior Economic Advisor
Trade and Economic Policy and Trade Litigation
Department of Foreign Affairs and International Trade

This paper was prepared for the National Policy Research Conference, Ottawa, November 30-December 1 2000. It attempts to provide a "horizontal" analysis of a number of trade-related issues, drawing on the results of research conducted under the aegis of the GCON Working Group on World Trade Issues and on some of the new trade policy literature that emerged during the course of 2000. The views expressed in this paper are those of the author; errors of interpretation or fact are the sole responsibility of the author as well. The usual disclaimer in respect of research prepared in a personal capacity by those in the public service also obtains: the views expressed are not to be attributed to the Department of Foreign Affairs and International Trade or to the Government of Canada.

Introduction and Overview

Disagreement over whether to develop additional multilateral instruments dealing with trade-related issues contributed to the failure to launch a new round of multilateral negotiations at the World Trade Organization (WTO) Ministerial meeting in Seattle. This disagreement persists: the United States and the European Union continue to insist on broadening the WTO agenda to include new issues, while developing countries express concern over this direction. Moreover, the epistemic trade policy community is also divided on the merits of

introducing new instruments to deal with trade-related issues in the body of multilateral trade rules; there is some currency to the view that several of the new directions taken in the Uruguay Round were not well advised and that it would be better to backtrack rather than to proceed further down that path. Accordingly, the multilateral system appears very much to be at a crossroads.

This paper takes a "horizontal" look at a number of trade-related issues to see if some general principles can be identified that could provide some guidance as to the way ahead. To set up this discussion, the paper first considers trade linkages from a "first principles" perspective and briefly reviews some of the relevant history of the evolution of the multilateral system. The conclusions that emerge from this survey are as follows:

First, the application of trade rules has constrained the design of domestic policies but not the substantive intent of domestic policies. By the same token, this makes trade rules an ineffective means to get at policy objectives that are broader than trade transactions, particularly in an extraterritorial way in foreign jurisdictions.

Second, the capacity to manage risk across borders is lower than within a state. This suggests that the capacity to expand trade in areas where risk is an important factor will lag the expansion of the role of the market within borders. A corollary of this is that, while trade policy can legitimately be expected to open up markets where they exist, it probably should not be used to create markets where they do not exist, since this risks pushing societies faster and further than their internal frameworks for managing market-related issues can cope with.

Third, in areas where the idea of market-determined outcomes collides with deep ethical, social and political principles and values and where the pursuit of wealth must give way to other concerns – including health (physical life), culture (socio-cultural life) and environment (ecological life) – the interests of trade should by the same token defer to domestic preferences.

Fourth, reflecting the inevitability of eventually declining returns to more wealth, coupled with high positive income

elasticities for "quality of life" factors such as health, richness of culture and a clean environment, the comparatively wealthy industrialized economies and comparatively income-poor developing economies will naturally have different preference structures. This suggests a multi-speed WTO for inclusion of trade-related "values" issues.

Fifth, social contracts are needed in any market-oriented society, even without trade, and the size of border effects gives scope to governments to maintain them in the presence of trade; accordingly, there is no barrier here to trade liberalization.

Sixth, WTO instruments should emphasize procedural rules and avoid building substantive rules into the body of hard-to-change WTO law.

Some Preliminary Considerations

A "first principles" perspective

Use of the market as the organizing principle for production at the national level permits, for well-known reasons, a much higher standard of living than does individual self-sufficiency. However, it raises several issues:

- It holds all individuals hostage to others carrying out their part in the division of labour, as well as making them dependent on the ability to participate in the division of labour.
- It opens the possibility of various types of "market failure" that would lead to inefficient outcomes.
- It overlays a powerful organizing framework based on individual choice on the underlying social, political and cultural systems and values of nation-states.

Nation-states have accordingly evolved social, political and economic regulatory frameworks that, respectively:

- control the risks to individuals implicit in the market-based organization of production and distribution (i.e. some form of "social contract");

- set out rules of the road (and establish institutions to enforce them) to promote efficiency in economic activity (i.e. economic and technical regulation); and
- contain the impact of the market on the social, political and cultural strata of the nation (what might be for convenience termed "social" regulation).

These frameworks are not static, as is shown by the recent history in the countries of the Organization for Economic Co-operation and Development of economic deregulation and privatization coupled with a parallel proliferation of social regulation concerning product standards, health and safety measures and environment. As Sylvia Ostry observes: "In the OECD countries social regulation started in the late 1960's and has been accelerating since then. The OECD has called the phenomenon 'regulatory inflation.' One could – with a bit of a stretch perhaps – say that the postwar economic regulatory state of the advanced countries is withering away, while the social regulatory state is alive, well, and growing: a curious mix of laissez-faire and laissez-regler."[1]

In retrospect, this is neither surprising nor paradoxical for two reasons.

First, the dismantling of economic regulation (which largely meant privatization and deregulation of the traditionally regulated sectors, namely telecommunications, transportation, finance and public utilities)[2] resulted in the externalization

---

[1] See S. Ostry, "WTO: Institutional Design for Better Governance," paper presented at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium*, Center for Business and Government, Harvard University, June 1-2, 2000.

[2] This trend was the product of many factors. Some countries went this route out of conviction; some followed suit as a political economy consensus formed; some were pushed in that direction by competitive pressures and some by their financiers. An important underlying factor was the growth of the volume of information that had to be processed to manage systems of the size and complexity attained within industrialized economies at a time of rapid technological change. The volume of information simply swamped decision-making structures based on centralized command, control and co-ordination and led to the introduction of decentralized or, better,

through social regulation of what had formerly been internal decision-rules, guidelines or simply tendencies engrained in the corporate culture of the state-controlled industries.

Second, research and development was industrialized. This was embodied in newly minted armies of technological search engines (a.k.a. R&D personnel). This was facilitated by growth in the number of graduates of higher education, aided by the improvements in computer technology, motivated by the profit potential of new products and pushed by policy (e.g. "national innovation system" frameworks that encouraged universities and public research organizations to collaborate with industry). The result was an explosion of new products, each of which in some measure affected society, not only in a direct sense but also through possible interactions with other products. Each new product thus gave rise to a growing number of potential new regulations designed to control some aspect of its interaction with the social and economic system at large.[3]

---

distributed decision making guided by general incentives and penalties (i.e. market-based systems).

[3] Whereas growth in the number of new products has been exponential in nature, potential interactions have grown at a combinatorial pace. Since combinatorial expansion dominates exponential growth the way that exponential growth dominates linear growth, the complexity of the economic system has soared. A good example is the history of interaction between the computer and the idea of a network. The idea of a computer network was first developed by the U.S. government to help government function in the aftermath of a nuclear war. Computer networks found their initial major application in supporting academic research collaboration, because it was universities that had mainframe computers. When the mainframe computer became ubiquitous within larger corporations, computer networks supported the fragmentation of production, which was manifest in the "outsourcing" wave of the 1980s. When the desktop computer, itself a spinoff from NASA's space program, became ubiquitous, the now well-established idea of a computer network gave rise to the World Wide Web. The modern Internet that emerged as a result interacts with virtually every aspect of society, creating almost boundless scope for potential new regulation. In different societies, the concerns will be different, as shown by the differences between, say, the United States and China in their responses to this phenomenon.

Given differences in resource endowments, stage of development, and historical influences on social, cultural and political structures, nation-states respond differently to technological and market developments. Accordingly, no two are identical in the specification of their economic regulatory frameworks, in the generosity of their social contracts, or in the breadth of scope given to the market. In short, each has a unique and continuously evolving policy "bundle."

Trade is nothing more than the extension of the market framework across national borders. This expands the potential gains from specialization and increased scale compared to what is attainable within individual states; at the same time, it also extends to the international dimension the issues raised by adoption of the market.

This has two basic implications. First, it brings the policy frameworks designed to deal with these issues at the national level into contact with one another. Second, it creates to some extent a need at the international level for policy and institutional frameworks analogous to those that exist at the national level.

While the set of international institutions to which this has given rise is extensive, it is nonetheless the case that domestic institutional and governance frameworks have been only partially and in many cases weakly replicated at the international level.[4] There is accordingly a very significant

---

[4] In terms of macroeconomic issues, the International Monetary Fund (IMF) provides a lender of last resort to illiquid countries, the Paris and London Clubs provide an analogue of bankruptcy courts, and there have even been some efforts through the World Bank and the UN to replicate national fiscal mechanisms for cushioning regional terms of trade shocks. In terms of microeconomic issues, there are thousands of active committees under the International Organization for Standardization addressing technical matters. The United Nations Commission on International Trade Law (UNCITRAL) provides, through instruments such as the Convention on Contracts for the International Sale of Goods, the basis for settling contractual disputes between private parties. The Bank for International Settlements (BIS) and the International Organization of Securities Commissions (IOSC) provide a form of international financial supervision and regulation. UN-sponsored mechanisms have been formed to deal with

asymmetry in capacity to manage risk across borders as compared to within borders. This is undoubtedly one of the major reasons for the size of border effects and the extent of home bias in economic transactions that have been identified in the literature.[5] Moreover, it complicates matters considerably for a rules-based trade system since, while known risks might be dealt with in the context of trade negotiations as deliberate trade-offs in an exchange of benefits, it will be very difficult to get populations to accept new risks emanating from traded goods or services on the basis of past negotiations (which in effect would involve pre-commitments of unknown import). In other words, the acceptance of new products in trade will likely lag their acceptance at a national level, raising obvious difficulties for application of the precautionary principle.

Given the uniqueness of the various national frameworks, they are generally not congruent to each other or to any international framework, other than minimalist frameworks based on the principle of the lowest common denominator. Any more ambitious framework, such as that developed for

---

issues such as the impact of economic activity on climate change, status of women and indigenous peoples (impact of globalization on traditional life). And "economic" aspects of international crime such as drug trafficking and money laundering have also been dealt with one way or another internationally (including by the G-7/G-8). And the list goes on. The comparative weakness of international instruments is inevitable because the most powerful instruments available to deal with market issues, such as the power to tax (which is fundamental to addressing distributional issues) and legal enforcement and redress are prerogatives of the nation-state.

[5] The likelihood of a transaction taking place across borders is very small compared to a domestic transaction. See J.F. Helliwell, *Globalization: Myths, Fact and Consequences*, Benefactors Lecture, 2000, C.D. Howe Institute, October 2000. For a discussion of home bias and related empirical puzzles in international trade and investment, see M. Obstfeld and K. Rogoff, "The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?" *NBER Macroeconomics Annual 2000* (forthcoming).

international trade, thus inevitably gives rise to what Sylvia Ostry has labelled "system friction."[6]

Some of the relevant history

System friction was little in evidence in the early years of the General Agreement on Tariffs and Trade (GATT). Indeed, it has been argued that within the old GATT regime an implicit buffer had existed between international and domestic policy space. In this scheme, international rules restricted protectionist policies but did not dictate the content of domestic rules. This was not entirely true, but any exceptions (e.g. transparency requirements for publication and administration of trade regulations, a pre-WTO "exception to the paradigm of negative prescription") seem to prove the rule.[7]

The ambitious systemic reforms of the Tokyo Round clearly pushed the envelope in this regard. New instruments such as the Agreement on Technical Barriers to Trade (TBT) and the Agreement on Customs Valuation introduced requirements for positive regulation far more significant than transparency rules.[8]

---

[6] See S. Ostry, "New Dimensions of Market Access: Challenges for the Trading System," in OECD, *New Dimensions of Market Access in a Globalising World Economy* (Paris: OECD, 1995); and *Governments and Corporations in a Shrinking World* (New York: Council on Foreign Relations, 1990).

[7] See W.A. Dymond and M.M. Hart, "Post-Modern Trade Policy: Reflections on the Challenges to Multilateral Trade Negotiations after Seattle," *Journal of World Trade* 34(3), 2000, p. 23, especially footnote 2.

[8] Dymond and Hart downplay the significance of these measures in comparison to later Uruguay Round developments, arguing that the GATT did not require any country to have a tariff regime (which would trigger the customs valuation requirements) or to have product standards (which would trigger the TBT provisions). Ibid., p. 24. Since most countries have tariffs and product standards, this argument is largely moot. These agreements did require domestic regulation in a de facto, if not a de jure, sense. Moreover, while the positive regulation introduced in the Tokyo Round was mostly procedural rather than substantive, even procedural regulation can have significant implications in terms of infrastructure requirements

Notably, both of these particular agreements also contained preambular statements of intent to achieve harmonization of standards. Moreover, other new instruments on subsidies and government procurement gave the GATT's national treatment provision newly found leverage inside national borders.

And system friction started to be seen: one example was the 1982 ruling by a GATT panel that a number of instruments used by Canada to exact performance requirements from foreign investors violated Canada's national treatment obligations; another was the European Community complaints at the GATT in the 1980s about Japan's close government-business relationship, perhaps the quintessential example of system friction.[9]

The Uruguay Round pushed the envelope still further: important innovations included: (a) the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which requires WTO members to comply with, *inter alia*, the Berne Convention; (b) the General Agreement on Trade in Services (GATS), which *inter alia* requires members to establish mechanisms to review administrative decisions affecting service providers; (c) the Agreement on Sanitary and Phytosanitary Measures (SPS), which requires demonstrable scientific support for measures; and (d) the Agreement on Agriculture, which elaborates rules on domestic support for producers. As Dymond and Hart argue, "Taken together these agreements, combined with the positive obligation to ensure conformity with WTO rules, the new powerful dispute settlement system, and the trade policy review mechanism, institutionalize a degree and intensity

---

(e.g. administrative procedures law as well as highly trained physical and social scientists); as Sylvia Ostry has pointed out, these were particularly burdensome for developing countries. See S. Ostry, "WTO: Institutional Design for Better Governance," op. cit.

[9] See W.A. Dymond and M.M. Hart, "Post-Modern Trade Policy," op. cit., pp. 23-24 and pp. 28-29.

of intervention into domestic governance which exceeds anything possible or contemplated under the GATT." [10]

There was still a further departure taken in the Uruguay Round from the traditional GATT approach to liberalization. The basic approach of the GATT was *symmetrical lowering* of trade barriers to *asymmetrical levels* (an approach that respected differences in initial conditions in the various GATT members). The TRIPS agreement involved *asymmetrical lowering* of barriers (or reform of rules, as was the case in TRIPS) to *symmetrical levels* or uniform provisions. The latter approach does not respect differences in domestic conditions in member countries and finds no support in economic theory or empirical research.[11]

And last but not least, the creation of an independent Appellate Body elevated the dispute settlement mechanism (at least in the view of some) to a form of international constitutional law. For example, Robert Howse and Kalypso Nicolaidis observe that the WTO "is often claimed to be performing constitutional functions, or to be an incipient global economic constitution." They add: "The proponents of a constitutional understanding of the WTO point to the new binding, juridically rigorous dispute settlement mechanism... [and] the explicit role such tribunals play in balancing competing public values, economic efficiency vs. health and safety goals for instance, in the scrutiny of domestic regulation."[12] In a similar vein, Sylvia Ostry writes: "Inevitably

---

[10] Ibid., p. 26. It should be noted that there are examples of far more onerous intrusion into domestic policy space outside the world of trade – for example, conditionality applied by the IMF and World Bank (whereby positive regulatory reforms are required to qualify for loans). Unlike the intrusions of trade rules, conditionality is discretionary and has far greater scope for diminution of national sovereignty.

[11] See J.D. Gaisford and R.S. Richardson, "The TRIPS Disagreement: Should GATT Traditions Have Been Abandoned?" in *The Estey Centre Journal of International Law and Trade Policy*, Vol. 1, No. 2, 2000.

[12] For a discussion and sources, see R. Howse and K. Nicolaidis, "Legitimacy and Global Governance: Why Constitutionalizing the WTO Is a Step Too Far," paper presented at the conference *Efficiency, Equity and*

the dispute panels and especially the Appellate Body have been forced to interpret the relevant WTO rules. And inevitably, as is the case with all courts and all legal rules, but even more so because some WTO rules are deliberately imprecise or 'creatively ambiguous', the interpretation has essentially involved these internationally appointed judges making law, i.e. defining the boundary for domestic policy space and reinforcing the perception – and reality – of the intrusive nature of the new system."[13]

But this understanding of the significance of the Uruguay Round innovations in the area of dispute settlement must be tempered by consideration of the comparative effectiveness of the old GATT mechanism, which (as has been observed by a number of commentators) is somewhat of a mystery. On the face of it, the GATT process was entirely toothless since the positive consent of the disputing parties was required both to begin the process and to accept its results. Yet it resulted in many panel decisions, most of which were adopted and, despite the absence of an orderly regime of sanctions, generally complied with. Moreover, it was not necessarily less used than the new dispute settlement under the WTO: while the number of cases has risen since GATT days, so has the number of member states and the volume of trade. Taking these latter scaling factors into account, the WTO mechanism has arguably been no busier than its GATT predecessor. The success of GATT

Legitimacy: The Multilateral Trading System at the Millennium, Center for Business and Government, Harvard University, June 1-2, 2000. Insofar as the WTO has actually assumed such a role, this is an unintentional outcome. As Debra Steger writes, "Uruguay Round negotiators did not intend to create a strong, new international court responsible for resolving trade disputes. Rather, their objective was to provide a security blanket or a 'safety valve'...to ensure against bad decisions of panels, as part of the *quid pro quo* for automatic adoption of panel reports by the DSB." See D. Steger, "The Appellate Body and Its Contribution to WTO Dispute Settlement," paper presented at the conference *The Political Economy of International Trade Law*, University of Minnesota, September 15-16, 2000.

[13] See S. Ostry, "WTO: Institutional Design for Better Governance," op. cit.

dispute resolution is often attributed more to GATT culture than to the design of the process or the leverage of trade. This suggests, at a minimum, that the comparative success of the GATT/WTO dispute settlement system does not rely entirely on the coercion implicit in suspension of trade benefits.

To summarize the discussion of the evolution of trade rules:

- The early GATT did not intrude much into domestic policy, although neither was it pure in this regard; moreover, it already contained significant potential for intrusiveness through the national treatment provision.
- Tokyo Round measures introduced positive regulatory requirements and gave new-found leverage to the national treatment provision. While mainly procedural in content, the new measures signalled in their preambular statements the objective of harmonization of rules.
- The Uruguay Round multiplied the number of agreements with positive regulatory requirements, introduced substantive regulation in addition to procedural regulation, made in one case the further leap to symmetrical final levels (i.e. harmonization) and introduced constitutional overtones into the rules-based multilateral system.

Seen in this light, the Uruguay Round was not quite as radical a departure as is often suggested; rather it appears to be an expansion of, and follow-through on, the breakthroughs achieved in the Tokyo Round, and in some sense the unfolding of a potential nested in the original GATT.

Thus, where "first principles" considerations lead to the conclusion that system friction is inevitable and that some accommodation of national rules to international standards is unavoidable if the full potential of trade to expand welfare is to be tapped, the history of the GATT suggests that this has always been implicit in the framework of multilateral rules and, moreover, has been "in the works" for several decades, going back at least as far as the Tokyo Round in the 1970s.

If system friction is indeed an inevitable consequence of the maturation of an international economic system, the questions then become: which rules to harmonize, to what extent, and with what implications for compromise of national objectives?

There are several pertinent observations here.

First, there is the empirical fact that "borders matter." Moreover, borders matter much more for services trade than for goods trade.[14] This may reflect the fact that services trade liberalization has lagged goods trade liberalization or the possibility that the importance of "localness" is far more important for services transactions, which is where the concerns about compromise are concentrated, than for goods purchases. One way or the other, the impact of trade on regulatory choices domestically (out of concern for possible competitive impacts on domestic industry), even in the context of highly integrated pair countries such as Canada and the United States, is as yet comparatively small.

Second, while trade negotiations and trade disputes by design constrain regulatory choices in terms of *how* to achieve given domestic policy objectives, whether or not they compromise the actual attainment of basic policy goals (e.g. either by ruling out the only technically feasible means or by ruling out the only financially feasible means) needs to be empirically demonstrated. These issues are addressed below.

---

[14] In a Canada-U.S. context, the likelihood of a cross-border intercity transaction involving goods has fallen from being some 20 times smaller pre-FTA than a similar transaction on one side of a national border to about 12 times smaller since the FTA. For services transactions, the likelihood was not much changed by the FTA and remains at over 30 times smaller than for an intranational transaction.

The Interface with Norms and Values

The areas where it is usually held that social norms and values are under pressure because of trade are the "usual suspects" of health, culture, the environment and labour standards. Each of these is a general rubric that subsumes a number of major and minor issues. A full discussion of each would be beyond the scope of this note; the discussion below seeks only to identify a few commonalities that might be the basis for useful principles in dealing with the various issues.

Trade and health

Trade and health has at least two major groups of issues that warrant comment in the present context: product safety issues, which are handled under the SPS Agreement and which currently feature in the debate over the precautionary principle; and trade in health services under the GATS, where controversies relate to the possible impacts that trade could have on national health services systems.

On the product safety issues, the key point raised in the preceding discussion is the asymmetry of the scope for risk management across borders compared to within a nation-state. Absent this asymmetry, and using domestic thresholds for acceptability of risks in a trade context seems eminently reasonable and makes resistance to accept these risks in a trade context seem protectionist. However, given the asymmetry, maintaining a higher threshold of acceptability of risk in trade than domestically seems less unreasonable.

Turning to the health services industry issue, this sector has enormous economic potential and therefore trade potential; yet trade volumes are relatively low, liberalization is little in

evidence and governments are dominant in the sector.[15] The reasons are well known:

- From a society's perspective, health has public good characteristics (with large positive externalities from good health and even larger negative externalities from disease, especially contagious disease).
- From the individual's perspective, health care is a basic necessity, a need not a want. Accordingly, ensuring adequate health care is an explicit, high-priority policy objective of most governments, quite independent of economic circumstances and goals.
- Moreover, there is an asymmetry of information between patients and health care providers, a circumstance that typically triggers regulation and supervision and constrains the role of the market.[16]
- More deeply, health is an area where notions of fairness and equality come into play strongly, indeed with overriding force (i.e. access to health care should not be based on ability to pay). As Gary Hufbauer has observed, societies may have largely reconciled themselves to great disparities in income, as the price to pay for having a wealthy society; however, societies may not be ready to accept similar large disparities in health outcomes.[17]

This does not preclude a role for markets either in developing health care as an industry (including explicitly for trade purposes by putting to good use excess supply where it exists for reciprocal provision of health care to non-residents) or in managing access through private sector insurance plans. Nor does it necessarily preclude for-profit competition by foreign

---

[15] See J. Vellinga, "International Trade, Health Systems and Services: A Health Policy Perspective," in J.M. Curtis (ed.), *Trade Policy Research 2001*, Department of Foreign Affairs and International Trade, Ottawa, December 2001.

[16] Ibid.

[17] See G. Hufbauer, "Trade and Coherence: Where the Major Gains Lie," in *Trade Policy Research 2001,* op. cit.

services suppliers through the various GATS modes: providing hospital/medical services a commercial presence in domestic communities, through movement of natural persons, or on a cross-border basis through "telehealth" service delivery.

However, there are many issues to be resolved before there would be comfort in many developed societies with a significant role for the private sector (and by extension for trade). These include:

- dealing with the moral hazard and adverse selection issues implicit in insurance systems, without at the same time undermining the objective of universal access;
- providing assurance of supply and of standards, which can be compromised in an industrial model when profits are squeezed and the industry faces market consolidation and cost containment pressures;[18]
- dealing with cross-border risk management issues, which include, *inter alia,* coverage of doctors against malpractice suits mounted in courts abroad; recognition of credentials earned abroad; and the risk of gaps in supply created by withdrawal of foreign providers (which would appear to be greater than the risk of domestic health care personnel moving abroad, yet another complicating asymmetry).

These are not problems of principle but of practicality. Nonetheless, the practicalities are sufficiently problematic that most industrialized countries maintain regulated systems for principal health services that feature more or less universal insured coverage, comprehensive coverage of benefits, income-based contributions, and administrative mechanisms to control costs; and few WTO members have made liberalization commitments under the GATS (Canada made none).

While the expansion of international trade in health services may be inevitable, as Vellinga concludes, the record to date

[18] Evidence of this has been found in the U.S. managed health care system: "Pressure to protect profit margins has led to such dubious business strategies as the avoidance of sick patients, the excessive micromanagement of physicians, the worsening of staff-to-patient ratios, and the outright denial of care." See Vellinga, op. cit., p. 171.

within the OECD is that government involvement in the health sector increases as national per capita incomes rise.

The bottom line here appears to be that the benefits delivered by the market system in terms of efficiency tend to be secondary to more basic health policy objectives of preserving life and health; accordingly, the role of the market (and therefore of trade) is likely to remain circumscribed. Moreover, given the asymmetry in cross-border versus domestic management of risks, this is an area where the expansion of trade is likely to lag any expansion of the market in a domestic context, and the interests of trade will likely have to defer to domestic concerns.

Trade and culture

In his review of the recent literature on trade and culture, Bruce Jamieson considers how trade liberalization affects cultural industries, how it impacts on the legitimacy of the nation-state as a repository of distinctive, common cultural values, how it impacts on national identities, and what might be its longer-term impact on social cohesion.[19] Jamieson concludes that cultural goods and services are not like other goods and services and that cultural diversity is preferable to homogeneity. This lays the basis for a role for governments to play in promoting and preserving cultural diversity and specifically at ensuring space for "Canadian voices telling Canadian stories."

This general notion is put into a framework that is tractable from the perspective of trade and economic policy through the observation that "the instruments of communication of this culture [are] the cultural industries."[20] These include, variously,

---

[19] See B. Jamieson, "Trade Liberalization: Culture, Identity and Social Cohesion," in *Trade Policy Research 2001,* op. cit.

[20] Department of Communications, *Vital Links: Canadian Cultural Industries* (1987). This notion is consistent with the community development/animation model of cultural policy that emphasizes the value of community self-knowledge and thus centres on the media that reflect the

"high culture" (opera, ballet and the fine arts); "ethnic culture" (folklore, traditional arts and architecture); and "popular culture" (film, theatre, television, music, mass-market books and mass-market periodicals). These industries serve a dual function: to individuals they provide information, entertainment, intellectual stimulation and so forth; for society they create shared ideas, condition shared attitudes, foster shared habits and shape shared opinions, all of which are important in one way or another to cultural identity and thus, by this theory, to social cohesion.[21] This dual function appears to be at the root of the notion that cultural goods and services are "different" from other goods and services.

In an industrial setting, cultural policy is delivered through industrial policy, cultural objectives become synonymous with domestic market output, and trade in cultural products becomes

---

community's image back to its constituents. There are alternative policy models, including promoting creation of, and access to, works of "high" culture (both national and international), preserving national heritage (including both artifacts and values) through publicly funded institutions, and promoting development of merit goods by popular culture industries. These are reviewed in B. Jamieson, op. cit.

[21] Insofar as there is any valid connection between media feedback of a given culture to its host society and social cohesion, this would be a powerful argument in support of a cultural policy delivered through the mass media, since social cohesion has been persuasively argued to have positive effects on the efficiency of economies, quite apart from the purely social benefits. However, the most widely cited economic theory of the link between social cohesion and economic performance, namely from Robert Putnam, bases this linkage on informal, purely local social interaction stimulated by membership in choral societies, bowling leagues, etc. This has little to do with "audiences" or the mass media (and arguably mass media are inimical to this concept of social cohesion, since they tend to displace active social participation with passive "audience" behaviour). It can further be observed that any self-referential feedback changes and distorts a system in unpredictable ways. Accordingly, while it is certain that Canadian cultural feedback will produce a different result than broadcast American influences, what that result might be is neither predictable nor controllable, simply different (e.g. it is not unreasonable to presume that the popularity of the rather belligerent "Joe Canadian" ads is in part a response to the "boy scout" images of Canadians that had dominated Canadian cultural feedback).

a source of trade-offs: opening up provides individuals the benefit of expanded choice and cultural producers with expanded markets; but the ensuing cultural spillovers associated with imports must then, by this theory, be taken to diminish cultural distinctiveness (and, by implication, social cohesion, if one accepts this part of the thesis).

The outline of the trade and culture issue sketched above is only part of the story. An important overlay is the perceived threat to local distinctions posed by globalization, of which trade is of course but one agent. By allegedly eradicating the distinctions that make us "us," globalization is equated with homogenization, which in turn means cultural destruction.[22] This sense of threat to local distinctions generates negative

---

[22] As Salman Rushdie has famously put it, globalization is an attack on "the world's precious localness: the Indianness of India, the Frenchness of France." The threat of homogenization, and associated calls for preservation of cultural diversity, is a recurring theme in the literature reviewed by Bruce Jamieson. See B. Jamieson, op. cit. Concern over homogenization is actually pure hyperbole. The concept has no practical meaning within national borders, and the extent of border effects discussed earlier is a guarantee of the persistence of distinctive traits from nation to nation. The sense of cultural diversity under threat is also hard to square with the historical evidence of the survival of distinct cultures under far more adverse circumstances than those posed by mere trade in goods and services. The world has seen survival of suppressed cultures (e.g. Greek culture under centuries of Ottoman rule), of stateless cultures (Basque culture and language), of purely local cultures (ranging from the persistence of features of cities such as the distinctively different *arrondissements* of Paris to regional dialects and accents), and of specific elements of particular cultures under different influences (Chinese *guanxi* has survived the Cultural Revolution on the mainland, British rule in Hong Kong, Portuguese rule in Macau and American influence in Taiwan). The idea of homogenization through the media is equally hard to square with the flourishing of wildly different subcultures within the most media-saturated corner of the world, the United States itself.

However, cultural convergence is a very real feature of globalization, as evidenced by the proliferation of common elements even within very distinct societies. Equally real is the acceleration of cultural evolution due to the combination of globalization and intense feedback from mass media. Both convergence and accelerated evolution are destructive of traditional cultures, which is very likely the root of the concern voiced over "homogenization."

reactions that reverberate through the trade system and specifically against globalization's corporate iconography.

Recognizing the sense of threat abroad, Jeffrey Garten, currently Dean of the Yale School of Management and a former undersecretary of commerce for international trade, has written, "The U.S. should do more than heed these warnings [of the impact of globalization on local cultures]; it should recognize that strong cultures are in America's self interest. If societies feel under assault, insecurities will be magnified, leading to policy paralysis, strident nationalism and anti-Americanism."[23]

One approach that has been promoted to deal with the *sui generis* problems associated with trade and culture is a new international instrument on cultural diversity. To be useful in a trade context, such an instrument would have to provide a basis for sorting out what cultural policies were to be safeguarded from trade disciplines (or alternatively, in what contexts cultural policies would be deferred to in trade rules). This would seem to require more than a minimalist affirmation of the value of cultural diversity. Yet given the fact that the world *is* culturally diverse, achieving a common vision on such a fine delineation of the scope of international trade rules seems too much to realistically hope for.

An alternative approach would be a sectoral agreement that would include cultural and entertainment goods and services within the framework of the WTO with special provisions for particular circumstances – similar to the approach taken for telecommunication services, where a reference paper set out the definitions and principles for the sector's peculiarities.[24] While the development of such an agreement would be complex and difficult, it would have the advantage of necessarily spelling out the management of specific practical issues, which a more general instrument on cultural diversity outside the WTO would

---

[23] Cited by Hilary Mackenzie, "Commodity vs. Culture: Battle Lines Are Drawn: It's a Challenge to Keep a Separate Canadian Identity in the Era of Global U.S. Pop Culture," *Ottawa Citizen,* March 16, 1999.

[24] Such an approach has been advanced by Keith Acheson and Christopher Maule. For a discussion and sources, see B. Jamieson, op. cit.

not provide. Such an instrument would likely be possible to negotiate only in the context of a round, unless the "critical mass" approach taken with the telecommunications agreement were adopted (an approach that might not be viable in this instance, given that the country that would stand to face the most constraints, the United States, would not likely come on board except on the basis of important offsetting benefits elsewhere, if ever).

Given the hurdles that either of the above approaches faces, there is a distinct possibility that, for the foreseeable future, cultural policies will have to fend for themselves within the current international trade law setting. On the face of it, this would leave cultural policies at some risk (especially insofar as they are identified with domestic industry interests, as they are in Canada). This reflects the fact that there is only one explicit safeguard for cultural policies in the GATT (a provision in respect of cinematographic films) plus the general exceptions provided for under Article XX, which might be hard to apply:

- For example, any trade dispute is likely to be in connection with the mass popular media, which are both the prime source of reinforcement of cultural identity according to the cultural transmission theory and the area where commercial interest, including trade interest, is highest.
- Second, there is no evidence that *any* nation is prepared to restrict the export of its own culture in order to allow other nations to preserve their own; quite the reverse – nations take great pride in their artists and cultural industries and actively promote their works abroad. In this context, protestations that restrictions on imports of cultural products are required for higher social goals are bound to sound hypocritical.
- Third, the standard economic concepts that underpin trade (comparative advantage across geographic areas, specialization and division of labour between countries, etc.), as well as the basic principles of trade policy (such as national treatment), are of little help in arriving at broadly acceptable solutions that balance import and export interests because they simply make no sense when applied to

"cultural" goods and services, the basic distinguishing characteristic of which is precisely where or by whom they are produced.

- Further, distinctions between cultural products based on nationality will often strain credulity because anything that might be identified as a cultural good or service is more likely to be associated in a geographical sense with what might be termed a "civilization" than with a national "culture."[25] This is particularly the case with any cultural product aimed at the global market.
- In a similar vein, the virtual impossibility of establishing in objective terms the point at which cultural imports start to erode cultural identity or impair social cohesion makes it difficult to disprove protectionist intent in a trade dispute context.

Indeed, in the only instance in which a cultural policy was challenged (Canada's split-run magazine policy), the policy was ruled WTO-inconsistent, despite the comparatively small share of the Canadian magazine market controlled by Canadian product. Among the important factors that contributed to this result were:

- numerous statements by Canadian policy makers affirming the protectionist intent of the policy (a direct result of the identification of the cultural policy with industry interests);[26]
- the difficulty of clearly showing a distinction between "Canadian" content and foreign content;[27] and

---

[25] For example, there is nothing distinctively "Canadian" about Glenn Gould's very distinctive rendition of the *Goldberg Variations,* although the recording is a product of the Canadian cultural industry, being recorded by a Canadian in a Canadian recording studio. Few would disagree, however, with this work being labelled a product of "Western civilization."

[26] For example, see the Appellate Body's discussion of this issue in *Canada – Certain Measures Concerning Periodicals: Report of the Appellate Body,* WT/DS31/AB/R, June 30, 1997, at p. 33. Here the Appellate Body cited various official Canadian statements that affirmed the intent to protect.

[27] Here the argument turned on the question of whether the products were "like," which in turn depended on whether they were "competitive."

- the stringency of the criteria for applicability of the Article XX exceptions, which require in particular that the exception be necessary to comply with another WTO-consistent law, which would be typically the case in an environmental law context but would not make much sense in a cultural policy context.[28]

At the same time, it needs to be borne in mind that this was the *only* such case in WTO history, despite the wide range of products that might be considered as "cultural" that are actively traded. Moreover, the ruling went only to the means and not to the cultural objective; in fact the panel went to some pains to emphasize that the objective of the cultural policy was not at issue, only the WTO-consistency of the mechanisms devised to achieve it.[29] This would be a very narrow base indeed from which to argue that cultural policies are being threatened by trade rules, despite the absence in the trade rules of provisions on which deference to cultural policies could readily be based.

Trade and the environment

The trade and environment debate represents well-trodden turf. As Steve Charnovitz has pointed out, this issue goes back at least to 1925 when William Smith Culbertson, one of the architects of America's trade reciprocity policy, suggested that "Following, or perhaps as part of, a conference on commercial policy [i.e. most favoured nation rules, unfair competition, market access, investment, etc.], there should be held a world

---

The Appellate Body cited various official Canadian statements that emphasized the competition between Canadian and U.S. magazines. Ibid., pp. 29-30.

[28] See the argument of the Panel on this issue at paragraphs 5.7 to 5.9 in *Canada – Certain Measures Concerning Periodicals: Report of the Panel*, WT/DS31/R, March 14, 1997, pp. 75-76.

[29] Ibid., at paragraph 5.9, p. 76.

conference on the conservation of natural resources."[30] Moreover, there has been considerable initiative in this field with 20 multilateral environmental agreements (MEAs) currently in force that include trade-related measures.[31]

Nonetheless, there is no evident consensus regarding the functional links between the two issue areas, let alone consensus on the broader normative aspects.[32]

The fact that this issue area remains so active despite its long history and the prolific analytical literature that it has stimulated reflects in large part the fact that it is very complicated and there are many strands to the discussion. For example, trade has been linked in one way or another to a wide range of environmental problems: pollution, resource depletion, global commons issues, endangered species, solid and hazardous wastes, and reduction of biodiversity. Moreover, the underlying analytical issues vary across the issue areas; they include spillovers/externalities of various types, problems of the commons, intertemporal problems, uncertainty and information deficiencies, and reversibility/irreversibility of consequences. Further, the role of contributing and contextual factors varies from issue to issue as well; these include the quality of definition and enforcement of property rights, the adequacy of regulatory capacity, poverty and stage of development, and governance issues of various types (including the possibility of misguided policy due to factors such as interest group pressures,

---

[30] See S. Charnovitz, "Living in an Ecolonomy: Environmental Cooperation and the GATT," paper prepared for the *Conference on Trade and the Environment*, Pacific Basin Research Center, John F. Kennedy School of Government, Harvard University, April 29-30, 1994.

[31] These 20 are a small subset of the overall set of 200 MEAs; the fact that the vast majority of MEAs do not contain trade provisions should not go without notice.

[32] More than one commentator has called the trade and environment debate a "dialogue of the deaf," and few see much progress in the WTO's Committee on Trade and the Environment (CTE). See, for example, W.A. Dymond, "Environment and Trade: Lessons of the MAI," Department of Foreign Affairs and International Trade (mimeo).

short-run focus, poor analysis, etc.). As well, the level at which the various issues are tractable varies from subnational governments to national governments to regional groups and multilateral organizations. Finally, the linkage between trade and the environment is also "complex" in the sense of there being important interactions across issue areas (e.g. the well-known interplay between deforestation, reduction in biodiversity, poverty and property rights).

For the purposes here, it is useful to start by examining the cases where trade *rules* and environment have actually come into conflict. In point of fact, the number of GATT/WTO cases in which environmental measures have been challenged is not very large at all. The WTO lists altogether eight disputes over environmental measures during the history of the GATT/WTO:[33]

- *United States – Prohibition of Imports of Tuna and Tuna Products from Canada.* In this 1982 case, Canada successfully challenged a U.S. restriction on imports of tuna from Canada that had been imposed as retaliation for Canadian authorities arresting U.S. fishing boats trawling illegally in Canadian waters.
- *Canada – Measures Affecting Exports of Unprocessed Herring and Salmon.* In this 1988 case, the United States successfully challenged Canadian export restrictions of unprocessed herring and salmon that Canada claimed were part of a system of fishery resource management aimed at preserving fish stocks.
- *Thailand – Restrictions on the Importation of and Internal Taxes on Cigarettes.* In this 1990 case, the United States

[33] Source: WTO website, Environment Disputes. A broader interpretation of what constitutes an environmental case would expand this list somewhat. For example, the recent dispute between Canada and Australia over the latter's ban on salmon imports had an environmental element insofar as the Australian measures were ostensibly for quarantine reasons to prevent the introduction of certain salmonid diseases into local fisheries.

successfully challenged a Thai import restriction on cigarettes based on a claim that chemicals and other additives contained in U.S. cigarettes might make them more harmful than those in Thai cigarettes.

- *United States – Restrictions on Imports of Tuna (Tuna-Dolphin).* In this 1991 case, Mexico and others challenged U.S. restrictions on imports of tuna from countries that did not meet U.S. environmental regulations designed to safeguard dolphins from tuna nets. The panel found against the U.S. ban on grounds of extraterritorial application of domestic laws but upheld as GATT-consistent the U.S. policy of requiring tuna products to be labelled "dolphin-safe" (leaving to consumers the choice of whether to buy the product). As it turned out, the report was not adopted (and so is not part of GATT/WTO law); Mexico and the United States negotiated a bilateral settlement.

- *United States – Restrictions on Imports of Tuna (Tuna-Dolphin II).* In this 1994 case, the European Union brought a similar challenge, again without resolution. Although the panel again found against the United States, the dispute lapsed with the transition from the GATT to the WTO.

- *United States – Taxes on Automobiles.* In this 1994 case, the EU challenged three U.S. tax measures: luxury and "gas guzzler" taxes on automobiles (which applied respectively to cars sold for over $30,000 and those attaining less than 22.5 miles per gallon) and the so-called Corporate Average Fuel Economy (CAFE) regulation, which required the average fuel economy for passenger cars manufactured in the United States or sold by any importer not to fall below 27.5 miles per gallon. Companies that were both importers and domestic manufacturers had to calculate average fuel economy separately for imported passenger automobiles and for those manufactured domestically. While the panel found the first two measures GATT-consistent, it found the separate accounting requirement for imported cars under the

CAFE regulation to be discriminatory. In any event, the panel report was never adopted.

- *United States – Standards for Reformulated and Conventional Gasoline.* In this 1995-1996 case, Venezuela and Brazil successfully challenged U.S. rules on the chemical characteristics of imported gasoline on grounds that these were stricter than the rules for domestically refined gasoline.

- *United States – Import Prohibition of Certain Shrimp and Shrimp Products (Shrimp-Turtle).* In this 1997-1998 case, India, Malaysia, Pakistan and Thailand successfully brought a joint complaint against a U.S. ban on imports of shrimp caught without U.S.-specified safeguards for endangered sea turtles. While the WTO ruled that measures to protect sea turtles would be legitimate under GATT Article XX, it ruled against the United States because the measures in question discriminated between WTO members, providing countries in the western hemisphere – mainly in the Caribbean – technical and financial assistance and longer transition periods for their fishermen to start using turtle-excluder devices than it did to the complainants.

Several observations are warranted. *First,* quite remarkably, the United States has been involved in each and every case, in all but two as the party being taken to the WTO, a fact that may explain the relatively high profile of this issue. *Second,* while the party defending the environmental measure consistently lost, the grounds were, variously: (a) extraterritorial application of its own laws (*Tuna-Dolphin*); (b) discriminatory application of environmental measures that were otherwise upheld as valid (*Shrimp-Turtle*, *Reformulated Gas*, *CAFE*); or (c) unauthorized retaliation (*United States-Tuna*). None of the cases spoke to the merits of the environmental objectives of the disputed measures. *Third,* no measure implemented pursuant to any of the multilateral environmental agreements that contain trade-related provisions has been the subject of a trade challenge under the GATT/WTO. *Fourth,* most of the cases are recent; in fact, all

but two were brought in the 1990s toward the end of a period of significant expansion of environmental and other regulation in the OECD countries. *Fifth,* and further to the preceding point, the number of environmental cases brought forward as a fraction of the number of environmental regulations that have been instituted globally is vanishingly small; bearing in mind the frequent presence of scope, and the not inconsiderable temptation, to use environmental regulations for covert protectionism, not to mention the ever-present scope for plain vanilla poor regulatory design, this is mildly astonishing.

Taking the various points together, there simply is no "smoking gun" here of trade rules undermining environmental regulation in the developed countries or of developed-country environmental regulations being successfully used for covert "green protectionism." Clearly, trade rules constrain the choice of regulatory design and therefore challenge to some extent the cleverness of regulatory authorities; however, the real challenge to cleverness in designing regulations would seem to be not in crafting environmental rules that are not discriminatory in a trade sense but rather in devising rules that are both environmental *and* effectively trade-protectionist.

Turning from the impact of trade rules to the impact of trade itself, it has been argued that trade impacts on environment through "regulatory chill" (environmental regulations not enacted because of competitiveness pressures stemming from trade); and by prompting a "race to the bottom" (the gutting of once-stringent regulations to compete with jurisdictions with weaker regulations). Both arguments depend on there being a powerful harmonizing influence on domestic regulation from trade or the potential of trade (or alternatively the movement of production to the territory of environmentally lax regimes). However, the message of the evidence that "borders matter" is that there is no such powerful harmonizing influence and that states have considerable leeway to enact social regulation of their choice. This alone leads to the expectation that empirical evidence would be lacking for either hypothesis. In point of fact, while the "regulatory chill" argument, being a statement concerning a counterfactual circumstance (what would have

prevailed absent trade), is neither provable nor disprovable, the "race to the bottom" argument appears to be flatly at odds with the proliferation of environmental regulation in OECD countries. In his survey of the literature on trade and environment issues, Rob Stranks concludes that neither contention has been supported by the evidence.[34]

Where then is the source of the heat in this debate? Controversy usually follows hot on the heels of failure. For the most part, the problem here appears to be not what was done but what was *not* done – in particular to prevent damage to the global commons. There is little disagreement with the contention that the "global commons" have not been well protected or managed: examples often cited include the depletion of the ozone layer, climate change, the extinction of species, pollution of the most remote ecosystems, and the collapse of major fisheries based on migratory fish stocks.[35]

While the operation of trade rules is not implicated in this failure (global commons are the subjects of MEAs and, as noted earlier, no action taken pursuant to any MEA has ever been challenged in the WTO), the role of trade has been so implicated through the "ecological footprint" argument.[36] This thesis applies the same logic as underpins the tradable permits approach to meeting global emissions reduction targets, namely that ecological deficits in some countries (e.g. emission of more carbon dioxide than the national carbon sinks can absorb) can be balanced by ecological surpluses in others.

To many, this is a question of good governance; and indeed, insofar as environmental issues involve quantifiable

---

[34] See R. Stranks, "Trade and Environment: Post-Seattle Looking Forward," in *Trade Policy Research 2001,* op. cit.

[35] For a discussion of the role that this plays in the issue of civil society participation in the WTO, see J.M. Curtis, "Trade and Civil Society: Toward Greater Transparency in the Multilateral Trade Process," in *Trade Policy Research 2001*, op. cit.

[36] See, for example, Mathis Wackernagel et al., *Ecological Footprints of Nations: How Much Nature Do They Use? – How Much Nature Do They Have?* (http://www.ecouncil.ac.cr/rio/focus/report/english/footprint).

externalities, they should indeed be tractable through good governance.[37] However, in a context where exhaustible resources are not priced appropriately by market economies,[38] where not all nations have adequate environmental regulations,[39]

---

[37] Bagwell and Staiger argue that the WTO may be well suited in its current form to help manage the pecuniary externalities associated with choices over environmental standards. Insofar as the problem is an incentive to shift protectionist pressures from tariffs, which are subject to disciplines, to labour and environmental standards, which are not, they argue that, "governments can maintain the right to unilaterally determine their own domestic standards without sacrificing global efficiency *provided that they face appropriate restrictions on their choices which offset this incentive"* (emphasis added). See K. Bagwell and R.W. Staiger, "Domestic Policies, National Sovereignty and International Economic Institutions," *Working Paper 7293*, NBER; available online at http://www.nber.org/papers/w7293

The application of this approach depends to some extent, however, on the market concepts of tastes and preferences in respect of risk-return. For example, if one can frame the issue of, say, environmental protection in terms of tastes or preferences, then the application of the general body of social choice literature leads to the legitimacy of choices that result in some measure of environmental damage. Different populations will have a different intensity of preference or "taste" for clean air or clean water; in such instances, market instruments (e.g. application of the polluter pays principle) are suggested to deal with the externalities flexibly so as to maximize welfare. However, it is hard to think of a "taste" for more or less species extinction; accordingly, there are limits to how far this notion of good governance can be pushed.

[38] This is a generally unassailable proposition since market pricing reflects the time preferences of individuals of the current generation and thus favours more short-term consumption than would be the case if the time preferences of societies, which being of indefinite longevity would discount future consumption much less than do individuals, dictated consumption choices.

[39] For example, taking the case of rain forest habitats of orangutans and the international plywood market, an unmistakable global choice is being made at the present time in favour of cheaper plywood at the expense of orangutans, in some measure due to inadequate regulation in countries that harbour orangutans. From the orangutans' point of view – as well as from the perspective of those who form a political constituency on their behalf – trade is therefore very much a part of the problem – even if, as in pretty much all such cases, trade is but one factor among many (e.g. in this case, *lebensraum* population pressures are also a major factor).

and where inadequate measurement and partial accounting frameworks leave public sector managers in effect "flying blind" as to actual levels of ecological stress,[40] trade may allow – and indeed encourage – unsustainable growth.

The theoretical link posited by the ecological footprint argument is therefore cogently framed; the policy implications then turn on the question of where the planet is vis-à-vis its "carrying capacity," an issue well beyond the scope of the present paper. The extent to which trade policy can be a useful tool to address issues of this type, however, does need to be addressed and will be dealt with later in this paper.

Trade and labour standards

The issue of trade and core labour standards also has several characteristics that are pertinent here. Core labour standards can embrace various wage and workplace issues that enter into the calculus of competitiveness (e.g. "living wage," hazardous job conditions, compensation for workplace injury, and collective bargaining); this aspect of the trade and labour debate will be addressed later in this paper. Of particular concern here are the issues that touch on basic human rights, including non-discrimination in hiring and remuneration (dealt with under International Labour Organization Conventions 100 and 111), child labour (dealt with under ILO Convention 138); and forced labour (dealt with under ILO Conventions 29 and 105).[41]

---

[40] The movement for "green GDP" accounting is aimed at improving the situation in this regard. Proponents of the ecological footprint thesis also argue that inadequate biophysical measurement obscures the extent to which technologies that appear to ease pressure on ecologies (e.g. filters or sewage treatment) actually do reduce natural capital input. See Wackernagel et al., op. cit.

[41] See W.A. Dymond, "Trade and Labour," Department of Foreign Affairs and International Trade (mimeo), p. 4. The relevant ILO conventions are from the 1998 Declaration on Fundamental Principles and Rights at Work.

These issues are not directly about trade but rather about policy choices in foreign jurisdictions. Nonetheless, insofar as those policy choices are based on production possibilities enabled by trade, then trade is implicated. This raises the question of the extent to which trade rules can be used to address such issues. In this regard, there are several considerations:[42]

First, using trade remedies to address these issues would result in problems being addressed only in those sectors that are significantly exposed to international trade. Insofar as the issues are manifest in non-export-intensive areas (e.g. child labour is, according to the ILO, little represented in export products), trade measures would have to aim for the overall economy, hitting directly many who are innocent of the targeted practice (and who might have little redress in countries with inadequate distributional frameworks) and probably having negative consequences for poverty.

Second, while the manifestation of the problem is at the industrial level (e.g. child labour in carpet weaving), the objective of trade measures would be to change higher-order domestic policies within the target nation (e.g. public education systems and social policies), not simply to prevent child labour in traded goods. The leverage of trade as an instrument is thus substantially weaker than if the target were simply industrial practices.

Third, trade measures would address the issues in countries whose policies are challenged, leaving similar problems elsewhere not addressed. Given that the poorer and less developed countries, which tend to have the worst labour practices, also trade the least, there would be an inherent tendency for a trade-rules approach to target lesser evils in trading countries while systematically ignoring worse abuses in non-trading countries.

Fourth, since the issue is not product-related but rather process-related, it is linked to the debate over non-product-

[42] This discussion follows for the most part W.A. Dymond, "Trade and Labour," op. cit.

related processes and production methods (npr-PPMs) in the technical barriers to trade context and faces many of the same technical hurdles in trade disputes.

Fifth, the WTO system favours consultation and settlement, rather than rule making. In the event of a settlement, the complaint may be withdrawn, with no formal legal ruling having been made. This could lead to the perverse result that the source of the complaint would remain in force and tolerated as an integral part of WTO rights and obligations. Alternatively, insofar as the sanctioned country chose to tolerate the sanctions (which might be optimal for it if the amount of trade affected were small or could be easily diverted to third markets, an important consideration here since the right to retaliate goes only to the complaining party, and multilateral sanctions are not allowed), WTO remedies would be exhausted without affecting the offensive practice.

Sixth, as a practical matter, most complaints would arise in the United States and European Union and target developing countries, deepening the North-South divide and contributing to geopolitical tensions.

Finally, and not inconsequentially, the trading system would thereby have embedded within it new mechanisms for contingent protection (which, based on experience with other such mechanisms, tend to lead to abuse for protectionist purposes).

These are quite compelling arguments; however, some practical considerations might temper the conclusion to which they lead. For one, to take a page from domestic policy implementation, the tax system is often used to advance policy goals – whether it be to stimulate research and development or to improve child welfare – unrelated to and in fact detrimental to the primary role of the tax system of raising revenue to finance the operations of government. Nonetheless, in a world where policy targets frequently outnumber effective policy instruments, countries make use of such instruments as are in

hand.[43] Clearly, use of trade policy in this sense to advance objectives in "trade-related" areas (or "trade-unrelated areas," as Professor Bhagwati pithily calls them) is not necessarily to be excluded, even if on trade policy grounds alone such use would not be recommended. Equally clearly, however, just as extensive use of the tax system has resulted in horrendously complicated tax codes that can leave governments flying blind as to the net policy effects, extensive use of the trade system for non-trade purposes could well result in more harm than good and would be ill advised.

In addition, preparedness to use the WTO or other trade instruments to advance such policy goals can provide an impetus to the revitalization of moribund international institutions that are the more appropriate instrument. This argument has been advanced in connection with the ILO, which, as a result of pressure to incorporate labour standards into the WTO, "is getting significantly more attention, more political support and more resources to deal with core labor standards, especially child labor."[44] It is interesting to note in this regard that in March 2000, the ILO, for the first time in its history,

---

[43] Indicative of the enormity of some of the problems with which the international community must in some way cope, at the time when Convention 192 came into force, a child-labour activist group, Global March, reported that there were some 250 million children at work, enslaved or conscripted for prostitution or as soldiers. See "Report Explores Global Spread of Child Labor," available from childhood@globalmarch.org

[44] Kimberly Ann Elliott, "The ILO and Enforcement of Core Labor Standards," *International Economics Policy Briefs*, Institute for International Economics, July 2000: http://207.238.152.36/NEWSLETR/briefs.htm. Elliott notes that the 1999 convention on elimination of the worst forms of child labour (ILO Convention 192) is being ratified at the fastest rate in ILO history. There may be some connection between this sudden alacrity and the increased attention being paid within the WTO to core labour standards. For example, at the first WTO Ministerial in Singapore in December 1996, WTO members renewed their commitment to the observance of internationally recognized core labour standards, while rejecting the use of labour standards for trade protectionist purposes. Subsequently, at the third WTO Ministerial in Seattle in December 1999, a number of proposals were put forward for working groups dealing with the trade and labour issue.

actually used its enforcement mechanism (Article 33) against Myanmar, leading to a rapid response from the authorities of that state.[45]

This case raises the question addressed earlier of whether the WTO's teeth are really all that much sharper than what would be possible elsewhere: in the end, as Elliott notes, the WTO leaves it to member governments to take action to remedy violations but does not suspend benefits itself. The ILO's process is not in principle different – and by implication no less potentially effective – if the will is there to use it.

Creating Wealth and Preserving Social Contracts

The second category of trade-related issues consists of those that have distributional or "social contract" aspects. Once the market is adopted as a means of economic organization, there are certain necessary consequences, including the acceptance of inequality in income as a basic fact of life, as well as the need for a social safety net to mitigate the impact of market shifts on individuals. However, insofar as the issues posed by the market turn on the distribution of wealth, they can be addressed, quite literally, by throwing money at them.[46] In other words, no matter how reluctantly and confrontationally, wealth and its distribution can be negotiated in an economic policy setting.

Trade liberalization typically forces domestic adjustment, with winners and losers. The bottom-line results then depend on three key things. First, liberalization must result in an expansion of the overall pie, thereby making Pareto-optimal outcomes

---

[45] Kimberly Ann Elliott, ibid.

[46] This, of course, overstates matters in some important ways, because it is not really possible to reduce all things to dollars and cents. For example, jobs are "ways of life" as well as a source of income, and industrial adjustment sometimes turns whole communities dependent on uncompetitive industries into ghost towns. What's lost is hard to value. Nonetheless, insofar as one can roughly quantify the non-pecuniary benefits of a job as psychic income, the analysis of the issue is not significantly affected.

feasible (i.e. the polity overall can be made better off with no one being worse off). Second, the internal capacity to deal with the distributional consequences must be in place.[47] And third, the adjustment needs to be fairly rapid since ultimately the legitimacy of liberalization as a policy depends squarely on results.[48]

---

[47] Just as risks are less readily managed across borders than within a state, so it is the case that the distributional consequences of structural adjustment to trade pose greater problems than in response to domestic market developments. Within a nation-state, distributional policies and social safety nets to soften the impact of restructuring, downsizing, plant closures and relocations, etc., are at least in principle sustainable because, while some in the nation lose, others gain and, in net terms, the tax base grows through greater economic efficiency. When market forces make allocational decisions across national borders, the situation can be very different because, in the short run, the winners may turn out to be predominantly on one side of the border (or in one grouping of nations sharing similar characteristics), while the losers are on the other side.

On the "winning side" (i.e. the nations that are the short-term net beneficiaries of liberalization), the tax base is boosted and demands on social safety nets reduced, allowing tax rates to be cut. At the same time, exchange rates would tend to be comparatively buoyant, asset markets would improve and interest rates could be lowered compared to where they otherwise would have been. On the other hand, on the "losing side" (i.e. those whose short-term adjustment costs exceed short-term benefits), the tax base is eroded and claims on social safety nets increase; at the same time, in a context of mobile capital, there may be reluctance to raise tax rates. These pressures can be further intensified by downward pressures on exchange rates and asset values and upward pressures on interest rates.

Meanwhile, the internal tensions within the society on the losing side would likely be exacerbated if liberalization changes the permeability of borders to different factors of production to different degrees and, as tends to be the case, capital is made relatively more mobile compared to labour, and skilled labour made comparatively more mobile compared to unskilled labour. In such circumstances, disparities in income distribution widen within economies. In a similar vein, increased job turnover due to restructuring leaves many workers with lower-paying jobs, notwithstanding the fact that, overall, the job structure might, because of the increased trade, shift toward more productive and higher-paying jobs.

[48] Robert Keohane and Joseph Nye present a cogent argument that the legitimacy of the trade system rests on its results rather than on its "democratic" procedures. What has created a problem of legitimacy for the

Unfortunately, economic theory offers no insight into how fast the adjustment will be, nor how deep a structural adjustment downturn may be. This underscores why states do not enter lightly into trade and/or investment liberalization agreements – the prospective gains have to be quite significant to warrant undertaking the various risks and burdens of change.

Canada's experience in this regard is examined by Philippe Massé in his contribution to the GCON Working Group on World Trade Issues.[49] Based on his literature review, Massé concludes that, viewed over a long period, trade appears to have contributed positively to employment growth in Canada, but has led to job losses in mostly low-technology, labour-intensive sectors that employ large numbers of low-skilled workers. Also of importance, the paper highlights that turnover in the labour market is very high, and in fact much larger than the effects that could be attributed to trade liberalization.

As regards the impact on wages, the paper concludes that the widening wage differentials observed in Canada reflect principally structural trends in terms of the demographics of the labour force and institutional structures and cannot be attributed either to trade or to technological change, although the shift in demand toward higher-skilled workers is due more to technology than to trade.

Since effective labour market policies are required to facilitate market adjustments due to technological and demographic change, there is not a strong reason to curtail trade and investment or to slow liberalization on social contract

---

international system in recent years, they suggest, is a lack of effectiveness. For example, the attack on the IMF in recent years derives in good measure from its lack of effectiveness in the Asian Crisis; by contrast, WHO got credit for eradicating smallpox (although its weak response on AIDS is eroding that credibility). See R. Keohane and J. Nye, "The Club Model of Multilateral Cooperation and the WTO: Problems of Democratic Legitimacy," paper presented at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium*, Center for Business and Government, Harvard University, June 1-2, 2000.

[49] See P. Massé, "Trade, Employment and Wages: A Review of the Literature," in *Trade Policy Research 2001*, op. cit.

grounds. In short, trade policy can in effect "free ride" on what is in any event an institutional requirement for any economy that buys into the market system in the first place.

Economic and Technical Regulation

The third class of domestic regulation identified earlier is that of economic and technical regulation. While in principle it should be easier to square domestic economic regulation with international rules, since governments should generally be indifferent to questions of how efficient outcomes are to be achieved, this is not actually the case because of the differences in initial conditions across jurisdictions, coupled with the general "second best" difficulties posed by sub-optimality being the rule rather than the exception.

Against this background, it is useful to take a look at one of the more controversial examples of the intrusion of international rules into domestic policy space to see if some lessons can be extracted as to how to deal more generally with the evidently broad range of such intrusions. TRIPS is a good test case in this regard because it is more or less purely economic regulation and might be considered the "pawn to king four" move in launching the implementation of the new trade policy agenda. Of particular interest here are the criticisms that are of a technical nature. In this regard, TRIPS has been criticized on:

- economic and technical grounds for:
    - creation of rents in excess of what would be optimal in terms of stimulating innovation;[50] and

[50] Intellectual property is a complex issue; there is an open debate about how much protection is required to provide the incentives for research and development that stimulates innovation. For example, the role of tacit knowledge is viewed by some analysts as a very significant factor conditioning the ability to actually use formal knowledge (or "template knowledge," which is readily copied), which affords intellectual property a good measure of protection even without regulations. See, for example, R.N. Langlois, "Knowledge, Absorptive Capability, and Organizations," *1998 APEC Economic Outlook Symposium* (APEC Secretariat, Singapore:

- the very choice of rent creation through granting of monopoly rights in lieu of alternative forms of intellectual property right protection, a choice that *inter alia* introduces constraints on competition into international law;
- more general economic welfare grounds for one-sided protection of producer rights without corresponding consideration of consumer rights;
- legal grounds (potentially undermining rights provided by World Intellectual Property Organization conventions to individuals to directly press their rights in domestic courts); and
- process grounds because TRIPS locks in a particular substantive regime that will be very hard to adjust given the requirement for consensus.

The question that these critiques raise is whether it is reasonable to expect a sound economic regulatory framework, in terms of choice and design of instruments, to emerge through international negotiations, at least insofar as these negotiations aim for positive regulatory outcomes? Second, even if an optimal regime could be so negotiated, is it wise to entrench any particular regime in a difficult-to-change international accord when changing conditions might warrant modifications from time to time?[51]

1998): 67-73. Moreover, the optimal amount of protection is thought to vary widely by industry. In some cases, technology can be readily reproduced through reverse engineering or the technology is embodied in an easily copied product (e.g. a bio-engineered grain that can be simply grown in order to obtain boundless copies). But this is not a uniform condition facing all industries.

[51] This has already become a practical concern, given developments in biotechnology, in view of TRIPS provisions that provide scope to exclude certain biological discoveries. TRIPS is controversial in a number of other ways. While a full discussion would be a digression, the issues are worth passing mention. First, some see TRIPS as anomalous in the multilateral framework since it did not entail an exchange of benefits between WTO members but rather a transfer of income from developing to developed countries (for an interesting game-theoretic estimate of the losses to developing countries that resulted from the asymmetric move to symmetric

This issue is complicated to some extent by the fact that much of the substantive force of TRIPS comes from its incorporation of existing substantive international agreements such as the Berne, Rome and Paris Conventions. However, it does incorporate substantive provisions of its own.[52] Moreover, the above critiques stand even for indirect incorporation of substantive measures, if the latter were agreed under a different implementation regime than TRIPS.

However, by embedding substantive regulation in the framework of multilateral rules, the Uruguay Round started to

---

levels of final protection, in contrast to GATT practice vis-à-vis tariffs of symmetric moves resulting in asymmetric levels of final protection, see J.D. Gaisford and R.S. Richardson, "The TRIPS Disagreement: Should GATT Traditions Have Been Abandoned?" *The Estey Centre Journal of International Law and Trade Policy*, Vol. 1, No. 2, 2000, pp. 137-170. This discussion nonetheless underscores the core commercial nature of the agreement, and one may equally ask why it is not legitimate to trade one commercial consideration for another of a different type? Moreover, developing countries did obtain some benefits, as is shown by India's recent move to extract royalties from Western pharmaceutical companies for use of plant remedies that originated in Indian folk medicine (see "The Trade Agenda," *The Economist,* November 11, 2000, p. 83). Given that tropical countries are host to the large majority of the globe's species, this provides developing countries with significant opportunities they may not have anticipated at the time of the Uruguay Round (see S. Ostry, "The Uruguay Round North-South Grand Bargain," paper presented at the conference *The Political Economy of International Trade Law,* University of Minnesota, September 15-16, 2000, p. 21). Moreover, insofar as some innovation in at least some developed countries is stimulated, some spillovers will accrue in the developing world. Implementing intellectual property protection also removed some impediments to imports by developing countries of goods embodying advanced technology and foreign direct investment in areas susceptible to piracy, generating additional economic benefits (e.g. see P.J. Smith, "Are Patents a Barrier to U.S. Exports?" *Journal of International Economics*, Vol. 48, No. 1, pp. 151-178). Furthermore, TRIPS added an important "arrow to the quiver" of developing countries in pressing retaliation against developed countries (e.g. the EU Bananas – Ecuador arbitration panel affirmed that withdrawal of TRIPS-based concessions is feasible).

[52] For example, the TRIPS Agreement specifies the protection that computer programs are to be afforded.

restrict the flexibility that GATT principles afforded domestic policy, namely that policy measures were subject only to the overriding principles of non-discrimination among trading partners and the use of the least trade restrictive measure required to achieve domestic policy objectives.

Finally, TRIPS includes a provision that is hard to justify given the discussion in this paper: under Article 8, TRIPS requires that even "measures necessary to protect public health and nutrition and to promote the public interest in sectors of vital importance to their socio-economic and technological development" must be consistent with the provisions of TRIPS – in other words, vital socio-economic objectives must defer to TRIPS objectives if there is a conflict in implementation.[53]

The bottom line, however, is that at the end of the year 2000, some 70 countries have yet to implement TRIPS commitments, discussion of implementation problems have failed to identify workable solutions, pressure for a fundamental re-evaluation is growing as new issues pile on, and important

---

[53] In this regard, TRIPs has been attacked on moral grounds for contributing to the human tragedy of AIDS in poor countries due to prevention of compulsory licensing of life-saving drugs. It is an interesting question how countries will react to a policy conflict of this nature. Redress for violation of TRIPS would require some jurisdictions – presumably the United States and/or European Union – to launch a complaint in the WTO. The politics of this would, in this type of situation, weigh against a complaint being launched in the first place (indeed, the U.S. has moved to deal with the problems posed by its intellectual property laws for sub-Saharan African countries seeking affordable access to AIDS drugs – see discussion in J. Vellinga, op. cit.). If a complaint were launched, the situation of the developing country would likely find considerable sympathy within the WTO. Even if some retaliation were authorized, such retaliation would have to pass through democratic procedures in the U.S. and the EU, where again a political gauntlet would have to be run. Even in the highly unlikely case that some retaliation were actually implemented, the developing country could simply suffer it, as the EU is suffering retaliation in the beef hormones case, while focussing on diverting its affected exports to third markets; given that developing-countries' exports tend to have high cross-price elasticities of demand, this would not be overly difficult. In short, there seems to be an open invitation to non-compliance in this element of TRIPS, which points to a flaw in its design.

ad hoc adjustments (by pharmaceutical companies regarding essential medicines) have already had to be made.

Conclusions and Future Directions

While the foregoing discussion amply testifies to the complexity of the issues, some conclusions can be teased out.

First, the trade-related "values" issues are not uniformly about domestic policy space; some are, including trade and health, trade and culture and aspects of trade and environment. Some, however, are about foreign policy (i.e. they concern circumstances and practices in foreign jurisdictions). These include the trade and core labour standards issue and trade and global environment issues.

In the past, the WTO's dispute settlement system has tended to avoid pronouncing on the merits of the substantive domestic policy issue implicated in a trade case, preferring to rule only on whether the means to the desired end was WTO-consistent. Moreover, it has not supported extraterritorial application of domestic policies.

These tendencies cut two ways. They help protect domestic policies from the reach of trade policies, provided they are implemented in a non-discriminatory manner, an issue of design not substance. At the same time, they make trade rules an ineffective means to get at policy objectives that are broader than trade transactions, particularly in an extraterritorial way in foreign jurisdictions.

Second, the capacity to manage risk across borders is lower than within a state. This suggests that the capacity to expand trade in areas where risk is an important factor will lag the expansion of the role of the market within borders. A corollary of this is that, while trade policy can legitimately be expected to open up markets where they exist, it probably should not be used to create markets where they do not exist, since this risks pushing societies faster and further than their internal frameworks for managing market-related issues can cope with.

Third, the "values" issues tend to involve public goods that are in some sense "non-negotiable" or, put another way, that are equal to or have primacy over the pursuit of wealth. These include health (physical life), culture (socio-cultural life) and environment (ecological life).

In a domestic setting, government policies constrain the reach of the market insofar as it is deemed necessary or convenient to balance the attainment of objectives in these areas versus giving rein to the pursuit of wealth. In an international context, there is some sentiment in the literature that this should be the case as well, that trade rules should show what might be termed "substantial deference" to domestic preferences in the case of issues where the idea of market-determined outcomes collides with deep ethical, social and political principles and values.[54]

Some change to the body of WTO law would seem to be required. For example, the TRIPS provision that gives precedence to intellectual property interests over vital socio-economic objectives if there is a conflict in implementation would seem to need reconsideration (not least because it has already had to be de facto reversed in the case of AIDS medicines for hard-hit nations). The difficulty of giving some deference to cultural concerns under the present formulation of Article XX (which requires that a measure be required for compliance with another WTO-consistent law to provide grounds for an exception) also suggests that Article XX needs some amendment. And the WTO's Dispute Settlement Body through exercise of essentially political judgement should attempt to steer the application of WTO law in such a way as to minimize system friction.[55]

---

[54] The term "substantial deference" is borrowed from Michael Trebilcock and Julie Soloway's article "International Trade Policy and Domestic Food Safety Regulation: The Case for Substantial Deference by the WTO Dispute Settlement Body under the SPS Agreement," presented at the conference *The Political Economy of International Trade Law*, University of Minnesota, September 15-16, 2000.

[55] For a detailed discussion of how it might be made to work in the SPS context, see M. Trebilcock and J. Soloway, op. cit. The rather adroit fashion

Fourth, reflecting the inevitability of eventually declining returns to more wealth, coupled with high positive income elasticities for "quality of life" factors such as health, richness of culture and a clean environment, the comparatively wealthy industrialized economies and comparatively income-poor developing economies will naturally have different preference structures. This suggests a two-speed WTO for inclusion of trade-related "values" issues.

Fifth, buying into the market economy necessitates development of social contracts, broadly writ, to control the risks to individuals. Extending the division of labour from a national basis to an international or global basis through trade and investment neither diminishes this need nor expands it. And in the present context of "thick" borders, it would appear safe to conclude that trade and investment does not compromise the ability of nation-states to preserve social contracts. The quid pro quo for obtaining the gains from trade would appear to be substantial deference to trade rules, even where they reach inside the border (something which appears inevitable and increasingly likely) and even where they necessitate

---

in which the WTO sorted out the *Shrimp-Turtle* case lends some encouragement that the WTO can show political sensitivity and what at least some observers consider proper deference to the underlying environmental concern. In particular, the case has been made that the preambular references to sustainable development in the WTO Act served an important role in guiding the Panel and Appellate Body decisions. This point is made by W.A. Dymond, "Environment and Trade: Lessons of the MAI," op. cit. At the same time, there is the overriding question of whether the dispute settlement system could bear the weight that this approach would put on it. Showing deference means applying judgement, which in these kinds of cases necessarily would involve judgements about the merits of the substantive issue implicated in a trade dispute. Rather than lowering the temperature, however, this might take the WTO from the frying pan directly into the fire. This suggests that the scope for dealing with these issues through judicial activism by the Dispute Settlement Body is very limited and formal agreements will have to be reached on each of the sensitive issues. While this can probably be done only in the context of a round, and therefore is likely to be some way off in the future, the light case load in this area provides some comfort concerning the possible erosion of domestic policies.

compensatory adjustments to domestic social contracts. In short, there is no reason why trade policy cannot in effect "free ride" on what is in any event an institutional requirement for any economy that buys into the market system in the first place.

Sixth, establishment of substantive technical regulation at the international level through a trade negotiation process, where shorter-term commercial considerations could well compromise the efficiency of the rules, does not appear to be a good idea. Even incorporation of substantive measures from other international agreements is subject to question if the implementation context in which those agreements were developed (not to mention the composition of the community that negotiated those agreements and/or joined voluntarily) differs from the WTO's. Generally, this suggests that WTO instruments should emphasize procedural rules, as does for example the Agreement on Sanitary and Phytosanitary Measures (SPS). At the same time, it suggests that instruments should avoid building substantive rules into the body of hard-to-change WTO law, as done by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Future directions

Trade policy (at least in its "legislative" sense, meaning multilateral negotiations for liberalization and further rule amendment or development) is currently in hiatus. By some estimates, this hiatus may be quite lengthy – especially if the terms of China's accession leave that country constrained in terms of offers for further liberalization in the short term, and if the European Union eventually finds that it needs to resolve its agricultural policies with respect to prospective entrants before, rather than in conjunction with, a new round. Accordingly, there may well be some time to develop a grand architecture of rules and/or relationships between various rule regimes to resolve the issues discussed above. At the same time, it is quite possible that determination of such a grand architecture may prove

impossible, if the inconclusive nature of the "coherence" discussions is any guide.

In the meantime, the WTO does not stand still. This reflects the fact that accession negotiations continue and the dispute settlement mechanism continues to function. The decisions and interpretations generated by the latter activity help not only to keep trade flowing by greasing the system, but also to fill in gaps and clarify murky passages in the legal framework of the WTO and to develop an information base that will support the next round of negotiations.

Accordingly, a lengthy hiatus in negotiations may yet be the optimal result for the WTO – and would not necessarily imply a hiatus in development of the multilateral framework. This is particularly the case because, as this survey has shown, the multilateral system is at a crossroads of sorts and careful thought about future directions is required.

Trade and Civil Society: Toward Greater Transparency in the Policy Process

John M. Curtis
Department of Foreign Affairs and International Trade

John M. Curtis is Senior Policy Advisor and Co-ordinator, Trade and Economic Policy, for the Department of Foreign Affairs and International Trade, and Chair of the PRI-GCON Working Group on World Trade Issues, on whose behalf this paper was prepared. *The paper builds on an earlier article entitled "Involving CSOs in Trade Policy Negotiations," published in* Optimum: The Journal of Public Management *(Vol. 30, No. 2, July 2000). The paper has benefited from comments by Bill Singleton of CIDA, and David Lee and Dan Ciuriak of the Department of Foreign Affairs and International Trade. The views expressed are those of the author and are not to be attributed to the Department of Foreign Affairs and International Trade or to the Government of Canada.*

Introduction

The involvement of civil society organizations (CSOs)[1] in the trade policy process has become perhaps *the* central issue in the lively and often acrimonious debate on the "democratic deficit" held by many to exist in the functioning of the multilateral trade system. Critics of the trade system and its crown jewel, the World

[1] The term "civil society" is both very old and very new. For the purposes of this paper, civil society organizations are considered very broadly to include groups of people claiming to represent perspectives on particular public policy issues.

Trade Organization (WTO), see such a deficit in the process of trade negotiations, in the administration of the system and, perhaps even more importantly, in the functioning of the WTO's Dispute Settlement Body, which in its first five years of existence is evolving into a serious pretender to the status of Supreme Court for the global economy.

This view not only persists but also appears to be gaining increasing currency, despite the unprecedented degree of consultation, transparency and openness evidenced in many countries (and especially in Canada) in the preparations for the abortive attempt to launch multilateral negotiations that ended in such disarray in Seattle in December 1999.

That Seattle marked the end of the "traditional" process of trade negotiations and administration of the multilateral trade system – which to many is little differentiated from the management of globalization itself – is disputed by virtually no one these days. The question is how, and by how much, to change: who to bring into the process, in what manner and subject to what constraints? That civil society, broadly writ, is to be part of the "who" is not in serious doubt. However, the nature and scope of CSO involvement is both complicated and highly sensitive. CSOs also differ amongst themselves and number in the tens of thousands; no easy formula to accommodate their participation is in hand. Domestic policy formulation processes differ widely from one WTO member economy to another – no organizational model is the right one, or acceptable to all. More importantly, there is the question of how much real influence over the outcome of negotiations or administrative decisions could or would be allowed by governments who comprise the membership of the WTO.

This paper takes up the question of what would be appropriate means to bring CSOs into the trade policy process in light of the developments that have brought the multilateral system to its current governance impasse, and of the new complexities that lie ahead – in terms of emerging new issues, a changing context and,

last but not least, in terms of prospective new members, most importantly China.

How We Got to Where We Are: The Road Map Looking Backwards

Some – and arguably the most significant – of the reasons behind the increasing involvement of civil society with the multilateral trade system can be summarized in the following stylized facts describing the evolution of the trade system and the globalization of the economy, which trade and investment at once contributes to, epitomizes, and is powered by.

Trade has become too important to be left to the elites

The rise in the importance of international trade since the Second World War is well known; however, its true extent and penetration into every society in every part of the world is rarely fully appreciated. The value of merchandise exports as a share of global GDP rose from about 7 percent in the early post-war period to around 25 percent by the close of the 20th century. At the same time, the more difficult to measure cross-border trade in services rose from a negligible percentage of global GDP to about 7 percent.

However, these statistics, dramatic as they may be, tell only part of the story. The growth of foreign direct investment has been such that the value of sales by foreign affiliates of multinational companies now is thought to be roughly equal to cross-border trade in the case of merchandise and is well over one and one half times larger than the value of cross-border trade in services.[2]

---

[2] As is recognized in the General Agreement on Trade in Services (GATS), sales through foreign affiliates ("commercial presence") is one of the modes of trade in services. Adding sales through commercial presence to cross-border sales thus gives a truer picture of the extent of services trade. Although it is not

Adding together exports of goods and services on a cross-border basis with sales through commercial presence, total "exports" in this broader sense would appear to be equivalent to two thirds of current global GDP. Imports, of course, account for a similar share of global GDP, emphasizing the extent to which trade has penetrated the pith and substance of economic activity worldwide.

These last statistics are rarely cited, yet their significance is felt deeply within societies. With the rise in the significance of trade and investment for economic growth and development around the world, public willingness to leave trade policy exclusively in the hands either of the politicians or of their trade policy experts appears to have begun to dissipate.

The trading system is probably not an exception in the sense of having long been managed by elites but coming under closer scrutiny more recently. As Robert Keohane and Joseph Nye point out, the General Agreement on Tariffs and Trade (GATT) fit well into the post-war international economic regime, which they describe in terms of a club model where each minister had his or her own international "club," dealing with its own cluster of

---

commonly done, one can do the same calculation for merchandize trade. This not only gives a better appreciation of the penetration that goods and services of foreign provenance have made into domestic economies, but also provides a summary statistic that encompasses both trade and investment flows, an important consideration given the fact that trade is "one-off," whereas investment cumulates over the years and generates a growing volume of sales. A few caveats are in order, however, with respect to this calculation. First, a large share of recent foreign direct investment has been in the form of cross-border mergers. In such instances, the ownership of the firm may change but there is no foreign content necessarily introduced into the goods or services produced by the firm. Second, with the fragmentation of production by multinational corporations across borders and the associated rise of intra-firm trade, the growth of trade in terms of gross flows has exceeded the growth of value-added generated through trade. While these developments have muddied the interpretation of trade statistics, the point remains that international commerce, broadly interpreted, considerably exceeds trade as measured by cross-border transactions alone.

issues, where international bargains could be struck involving either traditional international law or agreed practices ("soft law"), without close links to other issue areas. The club model kept outsiders out (including officials in other ministries within one's own government) and insulated ministers from domestic pressures, making it easier to work out agreements. Lack of transparency was thus purposeful and a means of reducing the cost of negotiations.[3]

The collapse of this "club model" more generally may also have been part of a larger social phenomenon. Sylvia Ostry has argued that the growth in citizen engagement "reflects a broader and more pervasive secular change in the industrialized countries – an alienation from the elite." As she notes (citing the work of American sociologist V.O. Key, Jr.), a "permissive consensus" existed for several decades following World War II: the general public supported the government's foreign policy, including trade policy, while knowing little about the details. This left governments free to sort out issues as they saw fit or expedient. Ostry points out: "The deference to government, and more broadly to the establishment as it was then termed, underlay the permissive consensus and has dramatically declined since the 1960's in all OECD countries as many recent analyses of opinion polls have demonstrated. Perhaps the Uruguay Round was the last gasp of the permissive consensus – and barely that."[4]

While the changes appeared to be quite dramatic in the 1990s, with hindsight it can be seen that the seeds were planted long ago. Over the decades, the policy process had been progressively opened up to a wider range of interested parties in many countries

---

[3] See R. Keohane and J. Nye, "The Club Model of Multilateral Cooperation and the WTO: Problems of Democratic Legitimacy," paper delivered at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium,* Center for Business and Government, Harvard University, June 1-2, 2000.

[4] See S. Ostry, "WTO: Institutional Design for Better Governance," paper delivered at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium,* Center for Business and Government, Harvard University, June 1-2, 2000.

around the world. While business representatives in many countries had been consulted on trade policy matters regularly or on an ad hoc basis from the 1950s onwards, over time the list broadened to include labour unions, small and medium-sized enterprises, public interest advocacy or citizen action/human rights groups, and consumer groups, never mind environmental associations – whether at the behest of governments looking for advice or analysis, in response to demands of the non-governmental groups to be heard, or in the interest of forging partnerships to implement agendas.[5]

Meanwhile, interest in trade matters within the general public also rose, stoked by – and in turn feeding – close media attention that raised the level of rhetoric, if not the level of understanding.[6] It has been some years since trade policy was shaped exclusively by technocratic advisors to governments and negotiated in a clubby atmosphere shielded from public scrutiny by diplomatic confidentiality. Such a circumstance is unlikely to emerge again.

Trade policy stepped "outside the box,"
treading tentatively but carrying a very big stick

[5] The involvement of CSOs in consultations obviously varies widely from jurisdiction to jurisdiction. Canada has long had policies on citizen participation in the policy process, ranging from outreach by civil servants to appearances by individuals and organizations before parliamentary committees. A high point for partnership between government and civil society was of course in the advancement of the ban on landmines, led by Foreign Affairs Minister Lloyd Axworthy and a range of activist civil society organizations that had international reach and substantial financial and human resources of their own.

[6] Sylvia Ostry suggests that the general lack of interest by the general public in trade negotiations persisted up to and included the Uruguay Round. As she puts it: "There was very little public interest in the Uruguay Round negotiations. As the new Director-General of the WTO, Mike Moore, has described it: 'The Uruguay Round was launched in the silence of public apathy.' The same could be said about the previous seven rounds since the creation of the GATT in 1948." See S. Ostry, "WTO: Institutional Design for Better Governance," op. cit.

Not only trade but also trade policy became increasingly more important over the years, for several reasons. First, as the share of global production that was traded grew, the character of the global economy evolved from what has been termed a model of "shallow integration" to a model of "deeper integration."

Second, the triumph of the market model, marked symbolically by the fall of the Berlin Wall in November 1989 (which culminated a period of change in regimes in much of Latin America, Africa and Asia), led to its application with increasing assuredness in many areas where considerations other than efficiency clamoured for attention.[7] Trade, being the leading "spear carrier" for market economics – as indeed it has been since the days of Adam Smith, David Ricardo and others who wrote the early economics largely as a defence of free trade[8] – bears, along with the IMF and the World Bank, the brunt of reaction – and there is no point in trying to duck this.

Third, and quite inevitably given the expansion of the share of trade in overall economic activity, trade policy began quite self-consciously to reach inside the border – which is the same as saying that it "stepped out" of its traditional "box" of reducing the level of barriers to trade at the border.[9]

---

[7] Three areas in particular stand out: health, culture and the environment. Societies have broadly reconciled themselves to living with inequalities of income in order to realize the efficiency benefits from applying the calculus of markets to economic production; they are not so inclined to accept the application of the market calculus to life itself – whether it be physical, social or ecological. The issue is not trade per se, but the growing weight of market economics in areas where efficiency must be traded off against other values.

[8] See W.W. Rostow, *Theorists of Economic Growth from David Hume to the Present*, Oxford University Press, 1990, p. 78.

[9] The following passage is representative of the reaction that the intrusion of trade rules inside the border has elicited: "Although still a little-known and little-understood institution, the WTO has become increasingly controversial as it has expanded the scope of its work from its original narrow GATT focus on reducing tariffs on manufactured goods. The WTO now also works to eliminate nontariff barriers, and can be used to challenge environmental, health, and other

The strengthening of enforcement powers through the creation of the Dispute Settlement Body (DSB) in the WTO had arguably even greater potential significance. In what is now going on seven years, the DSB has handled more than twice as many disputes as came before the GATT in close to half a century before that.[10] Moreover, it has been ruling on issues that touch profound social and cultural sensitivities: for Canada, these have included rulings on milk marketing boards and cultural policies on magazines; other rulings have touched on flashpoints such as trade in genetically modified foods and potential health hazards such as asbestos, on fisheries practices that endanger dolphins and turtles, and so on. The DSB has effectively been evolving into the equivalent of a global Supreme Court, ruling on a wide range of sensitive socio-economic issues. And, in a context where negative consensus rules the day (i.e. *every single WTO member* has to agree to overturn a decision), and where trade retaliation running into the billions of dollars can be unleashed to enforce its decisions, it is a very powerful Supreme Court at that.

Finally, in North America at least, NAFTA's Chapter 11 protection for investors has given some groups within societies – in this case foreign investors, who are actually "outsiders" in a national social context – the right to challenge in court decisions by democratically elected governments. CSOs might not consider

---

regulations that may serve legitimate social goals but may be regarded as impediments to international trade. The 1995 replacement of GATT by the WTO heightened concern among critics because its stronger enforcement powers represent a further shift in power from citizens and national governments to a global authority run by unelected bureaucrats. Business, academic, and government supporters applaud the WTO as a more muscular sheriff of the world trading system." See S. Anderson and J. Cavanagh, "In Focus: World Trade Organization," *Foreign Policy in Focus*, Vol. 2, No. 14 (Institute for Policy Studies, January 1997), available at http://www.foreignpolicy-infocus.org/briefs

[10] In large part, the growth in the number of cases reflects the expansion of the volume of global trade and the growth in the number of members of the WTO, rather than a rise in litigiousness, as sometimes has been argued. This observation is due to Marc Busch, Queen's University, Kingston, Ontario.

this a right "to die for" but certainly "to very vocally demonstrate for."

Thus, at a time when the widening application of market instruments and the in-reach of trade policy are creating tensions both within and among trading partners over domestic norms and the social institutions that embody them (which are also issues of great concern to civil society), trade policy institutions have acquired powerful leverage over these very same issues. It should come as no surprise that CSOs want "in" to trade policy – and not merely to be listened to and politely shown the door when the time comes for serious decision making.

Globalization changed the terms of the social bargain

At least in developed countries, globalization is making it increasingly difficult for governments to carry out some of their traditional social policy functions. In particular, the services of larger and larger segments of the working population are becoming more easily substitutable across national boundaries, resulting in increasingly difficult challenges in national labour markets.

At the same time, the competitive pressures on national economic systems from international trade directly constrain tax policy choices, while the debt burden arising from fiscal excesses in earlier decades continues to limit discretionary and program spending. Accordingly, the economic and fiscal bases for the balancing act between the interests of labour and capital that formed the basis of the post-war political economy have felt an impact – and precisely at a time when globalization has dealt a distinctly better hand to capital than to labour.

Given the evidence that international borders still matter, as the recent work of John McCallum and John Helliwell shows,[11] it

[11] See, for example, J.F. Helliwell, *Globalization: Myths, Fact and Consequences*, Benefactors Lecture, 2000, C.D. Howe Institute, October 2000.

is debatable how significant the impact has been (and how much of it can be legitimately attributed to globalization as opposed to other factors, such as technological change). However, whatever the facts may be, the impression has been broadly implanted that globalization has changed the terms of the social bargain in many countries and to varying degrees. Some CSOs have sensed this and have been rushing into what they see as at least a partial vacuum to influence, shape and/or replace some of governments' activities in administering the social contract. What they are clearly seeking is to *rebalance*, not simply to be heard.

Disparities widened

Related to the preceding factor, public discussion of open markets and of trade has increasingly centred on issues of fairness and of justice. An important, if not the main, driver for this debate has been the stunning emergence of nearly unimaginable tech-created wealth, co-existing with utter poverty in one and the same economy, at one and the same time, and because of one and the same underlying cause: market-driven economic principles as exemplified in its pre-eminent institutions, the stock market and the multilateral system of trade. The fact that, in many cases, this wealth has come into existence virtually overnight through financial market voracity for technology-related stocks floated in initial public offerings (IPOs), if anything accentuates the sense of unfairness (at least among those who missed the IPO boat!).

Thus, what many see as the success of more open markets and of better international trade rules,[12] others in our societies see as an

[12] What is perhaps even more interesting to note is that there is nothing in the theory of market economics that would ever predict the widening of income disparities that has characterized the most recent decade. Indeed, the Stolper-Samuelson variant of the main theory of international trade would suggest that we should have seen factor-price equalization – not only between the same factors in different economies but, given that capital is nothing other than transformed labour, also between different factors such as capital and labour in

irreversible march down a road toward ever-wider inequalities. This is something that they do not understand and something over which they sense they have little control. To some extent, this has fuelled the emergence of the CSO movement as a politically relevant social structure that responds to these issues.

In an ever more complex world, CSO expertise is needed

As the world economy became more complex over the past decade, governments in many countries were downsizing, particularly their policy analysis and development capacity. Thus, even as the amount of information was growing exponentially, governments were reducing their capacity to absorb and understand it.

Many CSOs represent the self-organization of individuals with keen interests in particular areas; they possess, therefore, a reservoir of knowledge, skills and perspective that could be deployed to great advantage for policy development. This includes information that bears on the gamut of trade policy issues, from negotiations to administration of the multilateral system to the effective disposition of trade disputes.

The effect of these recent and important developments is that, overall, governments have lost ground to some CSOs (as well as other organizations) in knowledge management. In short, many CSOs have become players because, in an information age, they possess information and the expertise to manage and deploy it.

Network technology empowered...networks

---

one and the same economy. The fact that this has not happened has not deterred triumphalism in market economics – although clearly it should have tempered it.

It has been argued that the economic basis for the existence of firms was informational efficiency.[13] This idea extends quite readily and naturally to any large, hierarchical organization, including much of the bureaucracy that supports public governance.

Horizontal networks are an alternative form for information management. Indeed, the dramatic decline in the cost of maintaining networks through the information and communications technology revolution has equally dramatically changed the competitive conditions between hierarchical organizations and horizontal networks, in favour of the latter.

Many of the descriptions of the "organization" of the protests in Seattle and Washington drew on military concepts of mobilization and co-ordination to explain the effectiveness of CSOs. However, their effectiveness was not based on traditional informational advantages of large hierarchical organizations; rather, it was based on the effectiveness in self-organization of large numbers of individuals and groups loosely linked in largely horizontal networks or what might be termed "swarms."[14]

---

[13] See R.H. Coase, "The Nature of the Firm," *Economica*, November 1937, pp. 386-405.

[14] Kevin Kelly, Executive Editor of *Wired* magazine, describes the advantages of "swarm systems" in terms of (a) their adaptability to a wide range of conditions; (b) their evolvability; (c) their resilience, which is based on multiple redundancies, which in turn means that failure of any one individual component in the system does not matter in particular; (d) their boundlessness, as positive feedback creates new structure – "a swarm can build its own scaffolding to build further structure"; and (e) their ability to generate novelty, which rests to an important extent on the combinatorially large number of possible connections of individuals or ideas within the system. At the same time, he describes swarms' negative features in terms of their being: (a) non-optimal in terms of efficiency (due to the same redundancy that makes them resilient); (b) non-controllable, because there is no authority in charge; (c) non-predictable, which is the flip side of novelty; (d) non-understandable, in the sense that outcomes of swarm behaviour cannot be traced linearly to particular causes; and (e) non-immediate, in the sense that it is not possible to mobilize the system at the flip of a switch (which is the strength of command and control

That network technology empowers networks is of course almost tautological. CSOs are able to share both substantive and tactical information and analysis with like-minded groups all over the world. They represent a new organizing principle for issue management. And this is largely built on technology.

"First we take Manhattan...": from Paris to Seattle to Washington

Leonard Cohen's counterculture anthem could have been written for the CSOs – if he had got the cities right. But the road ran not from Manhattan to Berlin, but rather from Paris, where CSOs celebrated the demise of the OECD-led negotiations for a Multilateral Agreement on Investment (a demise that in the estimation of many within the CSO ranks they also brought about); to Seattle, where organized CSO opposition stole the media show, materially delayed the proceedings and sapped political will when it was badly needed to overcome the deep substantive divides within the ranks of WTO members; and on to Washington four months later, where the World Bank/IMF meetings were the target.

There was a sense among some CSOs of increased confidence resulting from their perceived role in causing or precipitating the failure of negotiations under the auspices of the OECD between 1995 and 1998. That confidence has now soared in the wake of Seattle and Washington (and Prague, and Windsor, Ontario).

Many CSOs seem to believe that the business-directed agenda of the 1980s and early 1990s was successfully deflected by them and should continue to be so. Quebec City will be the next test for governments, CSOs, the media and others.

---

hierarchical systems). See K. Kelly, *Out of Control*, Addison-Wesley Publishing Company, 1994, pp. 22-24.

Political economy revolves around the nation-state, but who speaks for the global commons?

Finally, although circumstances continue to change, the fundamental organizing principle of the world's population (dating from the Treaty of Westphalia in 1648) and of the world economy remains the nation-state. While there has been much talk of the demise of this institution, as noted earlier, recent research suggests that this conclusion was premature: borders still matter very much and the nation-state remains very much in business.

The WTO is a creation of nation states; it is an intergovernmental instrument that is central to the governance of the international trade system. And Seattle notwithstanding, it is also one of the most successful of the international institutions – if not *the* most successful.

While the resources directly available to the WTO are not particularly large, the intellectual capital that supports it is huge. Most of this intellectual capital lies not within governments but in the extended trade policy intelligentsia scattered around think tanks and universities worldwide – and, as well, increasingly within the legal community, which is finding trade policy of growing interest due to the new-found litigiousness of the trade system, and which brings to the issues its own set of normative perspectives and its own technical tool kit.

The WTO thus has its own confident and resourceful supporters, who do not necessarily see the CSO "swarm" as intellectually on their own plane or worthy of participation in the high temple of capitalism.[15]

---

[15] In this regard, see M.J. Trebilcock, "Mostly Smoke and Mirrors: NGOs and the WTO," mimeo, U.S. Library of Congress and New York University Law School Conference, New York University Law School, March 10, 2000. Professor Trebilcock admits to the polemical nature of this otherwise scholarly article, having, as he puts it, "abandon[ed] the detachment of the Academy for the passions of the Acropolis." With the increasingly polemical nature of the dialogue between CSOs and trade policy practitioners, one senses that an "us versus them" attitude is becoming entrenched.

At the same time, while governments clearly speak for matters within their borders, and in democracies carry the additional authority conveyed by the fact that they also speak for the people within their borders,[16] there is an open question of "who speaks for the global commons?" Global institutions have, of course, been set up by governments to deal with these issues; however, there is increasing evidence that the ball is being dropped on global commons issues – whether it be with respect to migratory fish stocks, the ozone layer, pollution of the most remote ecosystems, global warming or biodiversity and extinction of species (which can scarcely be viewed in national terms, even though all land-based biological species fall within one nation-state or another).[17] In a world where legitimacy is ultimately conveyed by performance, the inadequacy of the intergovernmental institutions in defending the global commons has arguably made this area contestable. Insofar as CSOs self-select to defend the global commons, and provide a compelling case in the court of public opinion as to their commitment and understanding of the issues, the issue of "who do they represent?" at least in this narrow sense seems to fall away. Accordingly, with global commons issues intensifying, the stage would appear to be set for an escalation of the conflict.

---

[16] This point has been the basis for the sharpness of the reaction within many governments to the CSO pressure for some form of participation. A recent detailed articulation of this view is set out in D. Stairs, "Foreign Policy Consultations in a Globalizing World," in *Policy Matters*, Vol. 1, No. 8, Montreal: Institute for Research on Public Policy, December 2000.

[17] One senses that part of the impetus that is currently behind the discussion of the precautionary principle in fact derives from the at least tacitly acknowledged failures in managing the global commons.

How to Proceed – And What Lies in Store: The Road Map Looking Ahead

Given the circumstances, the central question is how best to engage new actors in our various countries in a creative and positive way while keeping in clear view the ultimate objective of more effective and enduring trade policies to achieve more sustainable economic growth.

First, it would seem appropriate and indeed necessary that governments get to know CSOs somewhat better. This will be no mean feat, given their proliferation.[18] In addressing this issue, Sylvia Ostry suggests that there are three broad functional categories of CSO coalitions or networks: "mobilization networks," whose chief objective is to rally support for a specific set of activities;[19] "technical networks" designed to provide information to CSOs to facilitate their participation in the policy process;[20] and networks dedicated to servicing developing

---

[18] As Robert Keohane and Joseph Nye point out, "In the last decade of the 20th century, the number of international NGOs grew from 6,000 to 26,000, ranging in size from the Worldwide Fund for Nature with 5 million members to tiny network organizations." These figures exclude national organizations, underscoring the numbers issue. See R. Keohane and J. Nye, "The Club Model of Multilateral Cooperation and the WTO: Problems of Democratic Legitimacy," op. cit.

[19] In this category, Ostry includes organizations such as Ralph Nader's Public Citizen and Global Trade Watch; the U.S.-based Preamble Center; the U.K.-based Friends of the Earth, the Direct Action Network (DAN), the Ruckus Society, and Turning Point, an organization formed recently to produce advertisements on the effects of globalization on the environment. See S. Ostry, "The Uruguay Round North-South Grand Bargain: Implications for Future Negotiations," paper presented at the conference *The Political Economy of International Trade Law*, University of Minnesota Law School, September 15-16, 2000.

[20] In this category, Ostry includes the Centre for International Environmental Law in Geneva and Washington; the International Institute for Sustainable Development in Winnipeg; the Institute for Agriculture and Trade Policy in Minneapolis; the International Centre for Trade and Sustainable Development in Geneva; WEED (World Economy, Ecology and Development)

countries, which she has dubbed a "virtual secretariat" for the latter.[21] Even this brief review underscores the need to approach CSOs on a rather more nuanced basis than has been the case to date. It also underscores the enormity of the challenge.

Secondly, in engaging CSOs, three solutions appear to suggest themselves: improved transparency, more and better analysis, and more inclusive consultations. All will necessitate a fundamental change in attitude on the part of governments, at both political and official levels. These ideas are taken up in turn below.

The case for transparency

With respect to transparency, it is clear that the entire system must be more open. Secrecy in our current socio-economic environment serves no one; it risks alienating everyone. For one thing, a lack of transparency breeds suspicion and cultivates an aura of exclusivity that is directly antithetical to democratic sensibilities. Secrecy is

---

in Bonn; and the Institute for Global Communications in Palo Alto, California. These institutions, which are for the most part focussed on environmental and legal issues, provide technical and strategic information in support of CSO participation in the policy process, with the objective of influencing policy mainly by operating through institutional channels. Ibid.

[21] In this category, Ostry includes the Malaysian-based Third World Network and the Geneva-based South Centre (which collaborate to promote "south" solidarity on policy issues); SEATINI (Southern and East African Trade and Information and Negotiations Initiative), which obtains funding from UNDP and UNCTAD and seeks to build the knowledge base and capabilities of African countries; Focus on the Global South in Thailand, which seeks to link grassroots CSOs working on development issues; the Indian-based CUTS (Consumer Unity and Trust Society), which focusses on trade and sustainable development; the French-based Rongead, which obtains funding from the European Commission and the French government as well as private sources for its work on agriculture, trade and sustainable development; the Oxford-based Intrac (International NGO Research Centre), which trains and consults on behalf of developing-country CSOs; and a number of traditional development CSOs such as Oxfam and Christian Aid. Op. cit.

resisted on principle in democracies because the public does not know what it hides – indeed, it invites the inference that it shelters from scrutiny power broking that trades off interests of some against benefits for others without adequate compensation.[22] The reality is, of course, that genuine power broking is rarely done in formal terms;[23] accordingly, if secrecy of formal proceedings shields anything from public awareness, it is most likely the lame arguments, lackadaisical involvement, long-windedness and rhetorical posturing that all too often are inflicted on those engaged in international discussions.

More fundamentally, secrecy in negotiations and administration undermines the very possibility of full accountability and, in a not unrelated matter, tends to reverse the benefits that flow from consultations – indeed, it may well give rise to cynicism as to whether consultation is to inform public policy or is simply undertaken to mollify public opinion. Accordingly, allowing more sunshine into the WTO would not only be good for the organization itself but would also remove some of the fuel that feeds the public demonstrations against it.

---

[22] This point also can be made in respect of the relationships amongst the members of the WTO itself, as was shown at Seattle by the adverse reaction to the proposal that emerged from the "green room" process by those WTO members not part of the group (the "green room" process consists of an informal consultative group within the WTO that tries to forge the basis for compromise amongst the larger trading economies as a precursor to proposals being put to the full membership). This issue is dubbed "I-transparency," or internal transparency in Geneva jargon, to distinguish it from "E-transparency," or external transparency, which is vis-à-vis non-members. For a discussion of the I-transparency issue, see S. Ostry, "The Uruguay Round North-South Grand Bargain: Implications for Future Negotiations," op. cit.

[23] For example, the forward movement in the Uruguay Round negotiations was to an important extent due to discussions in various small groups named after the restaurants in which they met, a point noted ruefully by those who ate their way through the Uruguay Round and have the waistlines to prove it. Nor, might it be said, is there anything untoward in this. Informal processes are no more foreign to intergovernmental affairs than golf-course deals are to business or brown-bag lunch discussions to CSO opinion generation.

CSOs have a well-established role in a national context as monitors of public policy implementation who use the media to hold governments accountable for honouring their commitments. The extension of this role to the WTO is perfectly natural and should be accommodated and facilitated insofar as is possible. At the same time, this would not resolve all issues: those most suspicious would conclude that transparency in the formal proceedings of the WTO would simply shift the "real" decision making to other, less well-lit venues.

How much transparency governments worldwide would be willing to allow into the WTO is an open question. Steps to promote distribution of documents, to place more official information on websites, and to facilitate and encourage more debriefings are necessary at a minimum.

The case for improved analysis

While the "democratic deficit" in the WTO, and the system of global governance more generally, was much discussed post-Seattle, the "analytical deficit" did not get as much attention. Yet arguably the lack of a compelling case for a new round was perhaps as much a factor in the ultimate demise of the Seattle Ministerial as any other. It should be noted that there are two facets to this argument: one is that the WTO members themselves were not convinced that the potential net benefits of a new round were too great to pass up; the second is that key constituencies such as business, as well as the general public, were equally unconvinced and thus did not provide the political support for the difficult decisions that ministers would inevitably have to make in "sensitive sectors." The analytical deficit thus reflects failure on both counts.[24]

---

[24] The inadequacy of the analytical case supporting a new round of multilateral negotiations is detailed in Dan Ciuriak, "The 'Trade and…' Agenda: Are We at a Crossroads?" *Trade Policy Research 2001,* Department of Foreign Affairs and International Trade, 2001. This study shows that estimated gains

Arming the trade policy community with a compelling case for further liberalization is thus a clear analytical priority issue. Over and above what it would mean for ministers, improved analysis would serve to inform more meaningful communications efforts by governments and the pro-trade lobby more generally.

The weakness of the government message has been labelled a "communications deficit." It has been argued that this deficit reflects the primacy of economic variables such as "trade" and "growth" over the ultimate objective of growth and improved well-being.[25]

This particular weakness in communications is not unrelated to several other unfortunate tendencies in modern economic dialogue, including the primacy given exports over imports in trade policy communications: exports are of course the basis for jobs but, in economic terms, a country exports in order to obtain the foreign earnings to import. Imports are the real objective of trade, yet this point is rarely made in "selling" trade liberalization.[26]

---

from a new round are considerable in gross terms, but the case for gains net of adjustment and other costs, including opportunity costs of pursuing alternative policy initiatives (e.g. technology dissemination) has simply not been made. Finally, while it was generally recognized that the key to the new round was a good offer (including market access and technical support) to the developing countries least integrated into the multilateral system, the adequacy of the package was never convincingly demonstrated.

[25] This observation is due to my colleague David Lee at the Department of Foreign Affairs and International Trade. He emphasizes that it is not enough to assert an indirect (e.g. "trickle down") benefit; rather, the detailed "working through" of the linkages and the handling of trade-offs need to be laid out for the dialogue to be meaningful to today's discussants.

[26] This point is developed in a study on the benefits of imports currently being developed by Clea Coronel of the Department of Foreign Affairs and International Trade. A second example, which is of tangential relevance here, is the triumph of national accounting language over common sense in everyday discourse. This has resulted in the arid accounting category of "consumption" turned into the idea of people being "consumers." In turn, this has led to the portrayal of all that individuals (or households) do as "consumption," whether it be enjoyment of the fresh air in a natural park (paid for by a ticket at the

One area in particular where governments, as well as non-governmental experts, will have to be more responsive is with regard to the expressions of uncertainty or of fear from the general public concerning the impact of liberalization: these uncertainties and fears should be faced head-on with facts and analysis; they cannot be dismissed as overreactions of the un- or ill-informed.[27]

Part of the burden of improved analysis needs to be shouldered by the WTO itself, both through expanded in-house research activity and through development of its own networks with academic and non-governmental think tanks and organizations. While the WTO Secretariat should not adopt an advocacy posture – that role should be assumed by the Director-General and the members themselves – it needs to be, and to be seen as, an authoritative voice on the issues themselves. The work of the

---

entrance), the viewing of a work of art (paid for by the price of admission to the museum or art gallery) or the obtaining of essential medical care (paid by medicare if one is fortunate enough to be Canadian). Labelled "consumption," such activities get lumped in with everything from gluttonous overeating to excessive use of gasoline from driving gas-guzzling SUVs to the corner store for milk. This allows the short and easily made intellectual leap from "consumption" to "excess consumption" by those who question the objective of growth with no more apparent ultimate purpose than to have more clothes than closet space or more cars than the roads can accommodate. By the same token, the expenditure on gasoline required to sit for an hour in rush-hour traffic, and the purchase of medicine to alleviate lung problems caused by breathing poisonous exhaust from other cars in the process, because infrastructure development has not kept pace with growth, are also considered "consumption." In the developed countries (especially during economic booms), the equation "more growth = greater welfare" cannot always be directly made; the "communications deficit" derives from the failure to internalize this.

[27] These concerns are many and varied, ranging from the impact of trade liberalization on social contracts and on the fabric of societies to the role of trade in truly fundamental issues such as global warming and biodiversity. These concerns generally fall under the rubric of "trade and ...", an issue area that is only starting to receive the in-depth rigorous analysis and policy attention that it deserves. For an overview, see Dan Ciuriak, "The 'Trade and...' Agenda: Are We at a Crossroads?", op. cit.

Secretariat should feed into the policy debate and, by the same token, open up channels for participation by outside experts in an intellectual capacity. Some ideas have been advanced as to how this might be done and what it would mean for the WTO.[28]

The case for improved consultations

Finally, governments, international institutions and non-governmental experts must not carry on trade policy discussions over the heads of the general population. More and more effort will have to be directed to building a consensus on issues affecting individuals directly, both in developed and in developing countries. In the national context, in Canada for example, public notices through the *Canada Gazette,* legislative hearings, ongoing private sector consultations or multi-stakeholder consultations, a more current, complete, user-friendly website as well as polling all can be used to help develop a consensus around national trade policy interests and objectives.

This consensus building can also be done in the WTO context, for example, by holding more high-level meetings on specific difficult issues, as was done in March 1999; wider distribution of documents will also help. However, the key issue revolves around a more direct involvement of CSOs in the work of the WTO.

In this regard, attention has centred on the acceptance by WTO panels and the Appellate Body of amicus curiae ("friends of the

---

[28] For example, Sylvia Ostry has proposed restoring to the WTO a body for policy discussion, which it has gone without since the suspension in 1990 of the Consultative Group of Eighteen (CG18): "In the terminology of the international regime literature the policy forum could become a broad meta-regime founded on mutually agreed basic principles and fostered by a combination of strategic assets: a knowledge infrastructure in the form of a research capability; a meeting infrastructure for knowledge diffusion, debate, peer group pressure; strategic planning and monitoring of policy performance." See S. Ostry, "WTO: Institutional Design for Better Governance," op. cit.

court") briefs in disputes. Amicus briefs have been admitted in several WTO cases:

- *United States – Shrimp Turtle:* In this highly controversial 1998 decision, the Appellate Body ruled that panels had the right to accept unsolicited information from non-governmental sources, and to accord it whatever weight was appropriate. The Appellate Body noted that Dispute Settlement Understanding (DSU) Article 13 allowed panels to "seek information," and concluded that this provided panels with the discretionary authority to accept and consider any information or advice submitted to them, whether requested or not.
- *United States – British Steel:* In this May 2000 decision, the Appellate Body determined that it too had the authority to receive and consider amicus briefs from non-governmental sources, where it found it "pertinent and useful to do so." The Appellate Body based this on the broad authority given it by the DSU to adopt procedural rules.
- On November 7, 2000, the Appellate Body Division decided, in the context of Canada's appeal of a decision upholding a French ban on asbestos imports in the *Canada – Asbestos* case, to establish a procedure to allow CSOs and others to seek to submit amicus briefs to the Appellate Body.

These actions by the WTO's Dispute Settlement Body (DSB) were warmly welcomed within the CSO community, which interpreted them as acknowledging the importance of civil society participation and the value that such participation could bring to the process. By the same token, these actions were highly controversial within the WTO membership; indeed, a special meeting of the WTO General Council was convened to review the procedure that the Appellate Body had established to allow CSOs to request permission to submit briefs.

That the DSB was "pushing the envelope" with these moves, and especially the latter two, is fairly clear, as they represented

decisions on matters that had been considered, but not agreed to, during the Review of the Dispute Settlement Understanding in 1998-1999. In particular, during the DSU Review, proposals had been made to:

- expand the Appellate Body's scope of review to allow it, under certain circumstances, to review "manifestly erroneous or unreasonable characterization or appreciation of the facts before a panel"; and
- deal with unsolicited information from outside sources.[29]

Amicus briefs would for the most part deal with facts and their interpretation rather than the interpretation of WTO provisions; accordingly, insofar as the Appellate Body restricts its scope of deliberation to interpretation of WTO law (which is where the failure of the members to amend the DSU in line with the proposal to expand the Appellate Body's scope of review left matters), the point of it receiving amicus briefs is unclear.

Similarly, the decision to establish procedures to accept unsolicited briefs represented a decision on a matter considered but left unresolved by WTO members during the DSU Review.[30] Further, it appears to create procedural inconsistencies in connection with two other proposals considered but not agreed to in the DSU Review:

- to open Appellate Body hearings to the public; and
- to allow WTO members that had not been third parties before a panel to appear before the Appellate Body on appeal.[31]

Insofar as those submitting amicus briefs might be invited to explain issues to the Appellate Body, members of the public

---

[29] See Debra P. Steger, "The Appellate Body and Its Contribution to WTO Dispute Settlement," paper submitted to the conference *The Political Economy of International Trade Law,* University of Minnesota Law School, September 15-16, 2000.

[30] A similar proposal had also been put forward unsuccessfully during the Uruguay Round.

[31] See Debra P. Steger, op. cit.

would be allowed into Appellate Body hearings. Moreover, unless other WTO members were given the same right, they would appear to be less privileged than CSOs.

How this issue will play itself out is unclear. The decision of the WTO *not* to accept briefs in the *Canada – Asbestos* case after several environmental CSOs and at least one academic requested permission to do so was interpreted by some CSOs as a clear sign of failure to "learn the lessons from Seattle."[32] Accordingly, there is more than a little public relations fallout from this for an organization that is sorely in need of better public relations. More importantly, the Appellate Body *has* dealt with substantive issues – and probably must continue to do so if it is to fulfil the broad purpose envisaged for it, namely of serving as a safeguard against bad panel decisions.[33]

Whatever the course ultimately charted by the WTO, governments and international institutions will have to make an attempt to engage constructively with as many non-government groups as possible. While experience shows that some of these groups will be reluctant and/or hostile, most CSOs will respond with interest and with positive ideas. The alternative is to be continually on the defensive, fending off criticism from both these groups and the media, which will often result in a waste of effort and of momentum.

---

[32] See "A Court without Friends? One Year after Seattle the WTO Slams the Door on NGOs," press release issued by Greenpeace International et al., November 22, 2000.

[33] The technical complexity of issues considered by the Appellate Body under the SPS Agreement – such as the Beef Hormones and Australian Salmon cases – provides some justification for procedural flexibility to admit expert witnesses. For a discussion of this issue, see M. Trebilcock and J. Soloway, "International Trade Policy and Domestic Food Safety Regulation: The Case for Substantial Deference by the WTO Dispute Settlement Body under the SPS Agreement," paper presented at the conference *The Political Economy of International Trade Law*, University of Minnesota Law School, September 15-16, 2000.

And, perhaps uncomfortably for those within the trade policy community, the possibility that policy may change due to the consultations must also be countenanced – and that trade rules may at times have to defer to other imperatives.[34]

Some Tentative Conclusions

Overall, given the information revolution and the evolution of a more democratic means of policy formulation in many countries around the world, increased involvement of CSOs will be a fact. And there will be difficulties: the rough and tumble tactics of some CSOs will not be comfortable for some politicians and particularly for their officials; expectations might be raised by the very fact of consultations that no government will be able to meet; and the process of negotiations might well be slowed down because of the need for, or expectation of, consultations.

Moreover, given the complexity and inexact nature of the social sciences, uncertainty about the appropriate policy to adopt in a given situation will never be entirely removed. In such circumstances, governments must lead, notwithstanding the fact that not all will agree. But equally clearly, it is best if governments lead after having benefited from a comprehensive debate in which all views are put on the table.[35]

---

[34] Michael Trebilcock and Julie Soloway make the case for "substantial deference" of WTO rules in certain cases. See M. Trebilcock and J. Soloway, op. cit. Dan Ciuriak generalizes this idea to instances where vital interests and social values are at play. See D. Ciuriak, "The 'Trade and…' Agenda: Are We at a Crossroads?" op. cit.

[35] A comment from Steve Charnovitz, a noted environmental lawyer, underscores this point most aptly: "Just as national democracy entails participation and debate at the domestic level, so too does democratic global governance entail participation by transnational NGOs. Politicians should act and decide as a result of listening to a vigorous debate. It is illusionary to think that governance can be improved by having the decisionmakers of today rule out options for the people of the future."

The advantages, particularly in the longer term, are many: public buy-in will be deeper and longer lasting, the substance of trade negotiations will be strengthened, and social cohesion in our various nation-states will be enhanced – all key to effective public policy and to the general betterment of society.

"Most WTO governments oppose NGO participation on the grounds that the WTO is an exclusive club of States/governments. Although this view of the WTO is certainly accurate on one level, it misses the possibility of a fuller conception of the WTO and its constituents. The recent WTO Section 301 panel, perhaps recognizing the hollowness in conventional images of the WTO, called our attention to the needs of individual traders. According to the panel, the multilateral trading system is 'composed not only of States but also, indeed mostly, of individual economic operators' (para. 7.76). One might doubt that the panel accurately states the international economic law of today, but I predict that they postulate the international law of tomorrow." See S. Charnovitz, "On Constitutionalizing the WTO: A Comment on Howse and Nicolaidis," discussants' comments delivered at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium,* Center for Business and Government, Harvard University (www.ksg.harvard.edu/cbg/trade).



Department of Foreign Affairs
and International Trade

Ministère des Affaires étrangères
et du Commerce international

Department of Foreign Affairs and International Trade
Ministère des Affaires étrangères et du Commerce international

Canada

Government Publications

CA1
EA
-T66



Trade Policy Research 2002



Trade Policy Research 2002

John M. Curtis and Dan Ciuriak
Editors

© Minister of Public Works and Government Services Canada 2002
ISBN 0-662-31893-5
Catalogue number: E2-211/2002E

(Publié également en français)

Table of Contents

Foreword and Acknowledgements

Part I: The New Round of Multilateral Trade Negotiations: The Context at the Starting Point

1. From Doha to Kananaskis: The Future of the World Trading System and the Crisis of Governance:
Daniel Drache, York University, and Sylvia Ostry, University of Toronto.....1

2. The Role of Contextual Factors in the Launching of Trade Rounds:
John M. Curtis, Department of Foreign Affairs and International Trade.....33

3. The Nuanced Case for the Doha Round:
John M. Curtis and Dan Ciuriak, Department of Foreign Affairs and International Trade.....71

Part II: Trade in Services: A Survey of the Issues

4. Benefits and costs of trade and investment liberalization in services: Implications from trade theory:
Brian R. Copeland, University of British Columbia...107

5. Measuring the Barriers to Trade in Services: Literature and Methodologies
Zhiqi Chen and Lawrence Schembri, Carleton University.....219

6. Trade and Investment in Canada's Services Sector: Performance and Prospects:
Shenjie Chen, Department of Foreign Affairs and International Trade.....287

Part I:

The New Round of Multilateral Trade Negotiations: The Context at the Starting Point

Foreword and Acknowledgements

This volume brings together the results of some of the trade-related research and analysis undertaken within and on behalf of the Department of Foreign Affairs and International Trade over the past year. It builds on the research base established by *Trade Policy Research 2001*, taking up several of the major themes broached in the various contributions to that earlier volume, in particular trade in services. At the same time, there is a major difference: whereas last year the emphasis was on sorting out the reasons for the failed WTO Ministerial Meeting in Seattle in November/December 1999, this year the emphasis is on understanding what changed to permit the successful launch of a new round of multilateral trade negotiations at the WTO Ministerial in Doha, Qatar, in November 2001, and what might be said about the prospects for the new round, the ninth since the inception of the GATT in 1947.

An important contribution of rigorous research is to sharpen the public debate on the key issues of our times. No issue is currently of more pervasive relevance to Canadians than globalization. And no issue is today subject to more extreme rhetoric—rhetoric that sheds far more heat than light on the subject that it purportedly discusses. Trade and investment are not all there is to globalization but obviously are two of its most important and visible engines. Improving general understanding of the case for trade, and more precisely the case for further trade liberalization, is therefore an important contribution to the democratic process of informed debate.

With Canada now fully engaged in a new round of multilateral negotiations, participating actively in the on-going work towards a broader regional free trade area within the Americas, and working to strengthen bilateral trade and investment relationships with particular trading partners, Canada has taken a strong pro-trade stance. It is worthwhile to recall that, at one time and in a rather more optimistic age, what we are now trying to achieve was taken for granted as the norm. In this regard, it is worthwhile to again return to John Maynard

Keynes (1883-1946) and his famous description of the globalized economy of the early 20th century, which came to an abrupt end when WWI broke out in 1914. He picked out the following features:

- Life was hard for the average person but, for those with talent and ambition, escape was possible into the middle and upper classes for whom life offered, "at a low cost and with the least trouble, conveniences, comforts, and amenities beyond the compass of the richest and most powerful monarchs of other ages."
- "The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep."
- "He could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages."
- "He could secure forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality."
- "He could then proceed abroad to foreign quarters, without knowledge of their religion, language, or customs, bearing coined wealth upon his person, and would consider himself greatly aggrieved and much surprised at the least interference."
- "But, most important of all, he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable."

The essence of this description is economic freedom. The freedom to buy, to sell, to invest, to travel without papers. Economic freedom was based solely on coined wealth, which hard work and ambition could achieve.

The world had its dark side back then to be sure—imperialism, colonialism and social problems that would motivate a century of activism and progressive policy making.

But this world was destroyed by the intervention of a long list of other "–isms" that were much worse: militarism, fascism, communism, totalitarianism; and, in the economic sphere, protectionism. These produced two world wars and a global depression in between.

Several generations of statesmen, diplomats and technocrats, Keynes amongst them, set out to rebuild that world that was lost in 1914. They started at Bretton Woods where the first draft of the international economic architecture was laid out, continued in San Francisco creating the United Nations, and moved ahead in Geneva through eight rounds of trade negotiations to restore the freedom to buy and sell and to invest around the world.

The United States, which had suffered the deepest depression due to loss of economic freedoms, became their strongest champion. The Europeans, who had suffered most from militarism, became the strongest champions of the borderless world, a version of which they have created in Europe. Europeans restored their freedom to move about and work where they choose within their political and economic union.

Now, even before full restoration is completed, these basic economic freedoms are again under assail from new "–isms": terrorism and anti-globalism.

We have not done a good job of teaching our children history. Many of them have grown up believing that the restoration of the state of economic freedom that a citizen of the Edwardian age would have considered normal, certain, and permanent was nothing more than a corporate conspiracy to maximize profits. And we have risen to the bait set by anti-globalists by trying to defend the abstraction they attack. We would do well to remind ourselves that we are still simply working to restore the concrete economic freedoms that Keynes so elegantly described. This the man in the street can relate to.

We hope to make a small contribution to this better understanding through the papers compiled in this volume. And, in the process, we continue to work in the spirit of the broader commitment of the Government of Canada to stimulate the development of research capacity within its various departments. Accordingly, the papers are written in the personal

capacity of the authors and do not represent the views of the Government of Canada or its Departments. At the same time, continuing the pattern set in *Trade Policy Research 2001*, the present volume also has several chapters devoted to the work of leading academic researchers. This combination helps maintain and indeed strengthen the bridge that must exist between the world of academia and the world of public policy.

Particular credit for stimulating and leading this effort is due to John M. Curtis, Senior Advisor and Co-ordinator, Trade and Economic Policy, at the Department of Foreign Affairs and International Trade (DFAIT). John again leveraged this output from a shoestring base budget.

Also deserving particular recognition are the contributors to this volume: Daniel Drache of the Robarts Centre at York University, Sylvia Ostry of the Munk Centre at the University of Toronto, Brian Copeland of the University of British Columbia, Ziqui Chen and Lawrence Schembri of Carleton University, and DFAIT economist Shenjie Chen.

And finally, particular credit goes go DFAIT's Dan Ciuriak for undertaking much of the editorial heavy lifting in pulling together a disparate group of papers, including some of his own work, into what this volume has become.

Leonard J. Edwards
Deputy Minister for Trade
Department of Foreign Affairs and International Trade

From Doha to Kananaskis: The Future of the World Trading System and the Crisis of Governance*

Daniel Drache and Sylvia Ostry

Perhaps the most important outcome of the fourth Ministerial Meeting of the World Trade Organization (WTO), which took place at Doha, Qatar, in November 2001, was that it did not fail; it achieved its stated goal, the launching of a new round of multilateral trade negotiations.

Whilst this may sound like damning with faint praise, the launch was, in the context, not insignificant since the ministers gathered at Doha bore a burden that transcended their portfolios. The shadow of what many have termed the "debacle at Seattle", where the third WTO Ministerial Meeting in

* This chapter highlights some of the main themes that emerged from the discussions at the conference "From Doha to Kananaskis: The Future of the World Trading System and the Crisis of Governance", Toronto, March 1-3, 2002. The conference was jointly organized by the Robarts Centre for Canadian Studies at York University and the Munk Centre for International Studies at the University of Toronto, with support from the Department of Foreign Affairs and International Trade. As these discussions were held under Chatham House rules, there is no attribution of statements to individual participants. In any event, the choice and elaboration of themes from an event such as this – a three-day conference involving academics, government officials and members of civil society that elicited a spirited debate on every issue raised – necessarily reflects the editorial judgement of those holding the pen. Responsibility for the text thus rests with the authors; the views expressed here are not to be attributed to the organizing institutions or to the Department of Foreign Affairs and International Trade. Papers from the conference are available online at www.robarts.yorku.ca. Daniel Drache is Director of the Robarts Centre, York University; Sylvia Ostry is Distinguished Research Fellow at the Munk Centre, University of Toronto. The assistance of Dan Ciuriak, Senior Economic Advisor, Trade and Economic Policy and Trade Litigation, Department of Foreign Affairs and International Trade, in developing the text is gratefully acknowledged.

November/December 1999 collapsed amidst divisiveness, dissent, and disorganization, was still not dispelled as the Doha meetings approached. The steady escalation of violence at the venues of international conferences[1] was giving rise to a sense of a growing crisis of global governance. And the destruction on September 11th 2001 of the World Trade Center was being interpreted symbolically by some as an attack on globalization itself. In this context, the cliché that "failure was not an option" gained fresh life.

By the same token, interpreting the success at Doha from the narrower perspective of its implications for the global trading system and the system of global governance is all the more difficult. To what extent did geopolitical necessity and drafting sophistry simply paper over substantive divides amongst the developed countries, between the developed countries and the developing countries, and perhaps even amongst the developing countries? Moreover, to what extent can it be said that the tempered atmosphere at Doha represented conciliation between governments and civil society, versus the "death of dissent" (or more ominously, as some put it, its criminalization) following September 11th—or simply the deliberately chosen isolation of the venue? And in substantive terms, to what extent did Doha address the issues surrounding the growing reach of WTO rules into domestic governance and the still unrequited desire of civil society for a role in trade negotiations, trade disputes and trade policy more generally?

The discussions at the conference from which this chapter draws its title as well as its substance shed much light on these issues. To bring out what was learned as concisely and cogently as possible, we focus first on the discussion of what happened at Doha, why it happened, and what challenges it poses for governments, for those in the business sector, those in environmental, social and other NGOs, and analysts in academia and research institutions. We then briefly consider the next steps in the ongoing process of coming to grips with global

[1] This escalation was set in sharp relief by the first death of a demonstrator at Genoa, July 2001, while the G7/8 meetings were being held.

governance issues, including the G7/8 conference to be hosted by Canada at Kananaskis in mid-2002. The main part of the paper then focuses on the major themes that were addressed at the conference and that will be dealt with in the multilateral round of trade negotiations launched at Doha, as well as in the upcoming summits and Ministerial meetings.

What Happened at Qatar?

There was much background activity before and during the intensive four days of meetings in Doha—theatre some might say—in the effort to make and characterize the deals that would permit a consensus to be forged: many meetings, much travel and a great deal of political will by all ministers involved. How was the deal forged and what is the nature of the expanded negotiations (outlined in the box below) set in motion at Doha?

The major elements of the Doha Round in brief

General: embedding development issues at the heart of WTO negotiations, including implementation issues, technical assistance and capacity building.

Non-agricultural products: improved market access, with agreement on modalities on tariffs and non-tariff measures (to the extent possible) targeted for end-March 2003.

Agriculture: modalities for further commitments on the three pillars of the Agreement on Agriculture (domestic support, disciplines on export subsidies, and market access) to be established by end-March, 2003.

Services: a firm timetable has been set for services negotiations with tabling of initial requests by end-June, 2002, and initial offers by end-March, 2003.

Trade-Related Intellectual Property: over and above the political declaration on TRIPS and public health, negotiations will be held on a limited number of technical issues (in particular on a wines and spirits registry).

Rules negotiations: negotiations are to address disciplines on subsidies, antidumping and countervailing duties, as well as regional trade agreements.

Systemic issues: improvements to the dispute settlement system, and consideration of the interaction between the WTO and the Multilateral Environmental Agreements (MEAs).

A Round or an Agenda?

The first controversy that emerged after trade ministers declared success at Doha centred on whether: (a) a round had been launched (in the customary meaning of these words); (b) the decision represented a "rolling launch" with the real decisions having been put off until the fifth Ministerial Meeting to be held in Mexico late in 2003; or (c) what had been agreed to was better characterized as an agenda—which in large part would be a "development agenda".

The fact that all of these perspectives could legitimately be put forward was eloquent testimony to the subtlety of the drafting of the final communiqué. At the same time, the need for subtlety reflected the persistence of divisions on substantive and procedural matters between the WTO members present at the Doha meetings.

The Embedded Development Agenda

With developing countries constituting the vast majority of the WTO's 142 members at the time of the Doha meetings, with the major source for remaining gains from trade liberalization being in developing countries, and with developing countries as a group being least committed to proceeding with a new round at any cost, it was inevitable that development issues would be featured prominently in the Doha Declaration.

Many (but not all) developing countries remained convinced that the Uruguay Round had been a one-sided deal, involving commitments for major structural reforms on their part in return for market access that had not been forthcoming,[2] and that they were not enjoying the benefits from freer trade that had been predicted. At the same time, while many developing countries may have signed onto the agreement at Marrakech that

[2] As was pointed out, the timetable for implementation of the WTO's intellectual property rights regime was linked to the phasing out of the quotas on textiles and clothing, reflecting the nature of the trade-offs that had been struck in concluding the Uruguay Round.

concluded the Uruguay Round without fully appreciating what they were getting into, or realizing the value of the veto that they had thereby acquired, they were much better prepared this time around. And, equally importantly, they were prepared to exercise their new-found clout.[3]

By the same token, there was little question that the countries primarily in the *demandeur* position at Doha were the industrialized group. The question was whether the industrialized countries would be able to move far enough to keep the developing countries—who were, in the view of some, quite prepared to walk away from Doha without a launch—from doing just that.

As it turned out, there is scarcely a paragraph in the Doha Declaration that does not mention developing country market access, special and differential measures for implementation of WTO agreements, or technical assistance and capacity building.

Flexibility on TRIPS

The ice-breaker in generating movement towards the apparent consensus was, in the estimation of most, the willingness signalled early in the Doha process by the United States—but also by other countries including notably Switzerland and Canada—on the issue of access to essential medicines within the broader context of the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

This issue was of deep concern to many developing countries and to large sections of the population in the developed countries. Economic analysis provides only qualified support for the technical framing of the TRIPS Agreement; in trade policy terms, the sharp movement towards harmonization and "one size fits all" regulatory structures embodied in this agreement is considered dubious by some observers. Moreover, the battle for the moral high ground on this issue was barely

[3] As was observed, resistance to the idea of altering the consensus-based approach in the WTO reflected to a good extent the interest of developing countries in preserving their effective veto in the consensus-based format.

contested given: (a) the acknowledged lack of attention given by the world-wide pharmaceuticals industry to tropical diseases; (b) the highly publicized and apparently effective approaches that appeared to infringe the TRIPS regime taken in recent years by several WTO members to address the spread of HIV-AIDS; and (c) the resort on an urgent basis in late 2001 by some wealthy nations to compulsory licensing of anthrax drugs in the wake of the series of terrorist incidents involving this bacterium. Accordingly, the only question facing ministers at Doha was *how* to move.

In the end, it was not entirely clear whether the question was answered or not. The ministerial declaration on TRIPS and Public Health was characterized as "political" in nature (as opposed to, for example, being described as having "legal" standing). But perhaps this did not matter; if in the course of a dispute the political declaration could be cited as grounds for invoking the flexibility in the TRIPS agreement, as developing countries stated upon emerging from the ministerial discussions, the distinction was moot. Moreover, there was the declared intent of the parties not to use the WTO's dispute settlement mechanism to deal with cases involving public health. This made the whole issue even less consequential. Accordingly, the "clarification" that the TRIPS agreement *already* provided flexibility to deal with public health emergencies might be interpreted as euphemistic language to describe a real retreat.

At the same time, some parties emerged from the meetings contending that, indeed, nothing really had changed. To the outside observer attempting to discern whether the latter position was face-saving bravado or hard-edged *realpolitik* judgement remained, despite the clarifications, clear as mud.

Anti-dumping

While the show of flexibility on TRIPS got the ball rolling at Doha, a significant boost to the momentum of the process was also provided when United States Trade Representative Robert Zoellick accepted anti-dumping and other elements of trade remedy law being put on the table—notwithstanding strong

pressures, including letters advising against this move by a large number of U.S. Senators and Representatives.

Coming mid-way through the Doha meetings, this signal of flexibility was extremely helpful in bringing developing countries on side, reflecting the extent to which anti-dumping actions tend to be aimed at them—and in light of the pressure on the U.S. administration for safeguards action in areas such as steel and lumber, as recession and a highly valued U.S. dollar combined to squeeze U.S. commodity producers.

Singapore Issues: negotiations definitely or only maybe?

A further important "deal maker" was the European Union's show of flexibility on the so-called "Singapore Issues"—investment, competition policy, transparency in government procurement and trade facilitation.

The European Union's insistence on inclusion of these issues in the forthcoming multilateral trade negotiations is a matter of curiosity to many observers, there being little obvious political pressure within Europe on these issues (with the possible exception of competition policy).

At the same time, many developing countries are decidedly set against inclusion of these issues, preferring instead to deal with an agenda focussed on traditional trade matters—most importantly improved market access.

Refined drafting came into play to help resolve the apparent impasse. At Doha, it was agreed that these issues would be studied in working groups, with a decision to be taken at the fifth Ministerial Meeting in Mexico in 2003 as to how to proceed. The question was: would negotiations on these issues automatically be launched at the fifth Ministerial with only modalities to be decided? Or would the decision whether to negotiate also be taken with finality at that Ministerial? The language of the communiqué skilfully glossed over this important difference, allowing different parties to offer varying interpretations following the Doha meeting.

Agriculture

Agreement on language on agricultural trade reform represented a final key area in bridging differences, in particular on two issues that were especially contentious.

First, there was the question of linkage between agriculture and environmental issues. Agreement to separate these issues was a major concession by the European Union, which greatly facilitated the achievement of consensus.

Second, there was the question of how to characterize the strengthening of WTO disciplines on export subsidies in agriculture. It had been agreed coming into Doha that negotiations would involve reductions in export subsidies. The question was whether the eventual end point would be acknowledged to be zero export subsidies, or whether the negotiations would proceed "with a view to" eventual elimination. In the minds of the drafters at least, the distinction carried code language significance.

The multilateralists supported as a matter of course

There remains to mention one group of countries that played a role, apart from the United States, the European Union and the large and heterogeneous group of developing countries. This group might be described as the confirmed multilateralists—countries that tend to see a strong multilateral trade framework as strongly in their interests, over and above the commercial benefits that might flow from a negotiated reduction of trade barriers. These countries include the medium-sized, trade-oriented industrialized members of the OECD, including Canada, that are not part of the European Union.

The domestic and international dynamics were quite different for this group than they were in 1986 when the Uruguay Round negotiations were launched. In good measure, this reflected the way in which the context for trade negotiations had changed. With trade barriers substantially reduced and with trade negotiations taking more time to deal with issues than is tolerable for commercially important business matters, getting

the business sector to pay attention to multilateral issues in the lead-up to Doha was substantially more difficult.[4] At the same time, new parties within each society were clamouring for greater input into the development of positions for trade negotiations, into the conduct of the negotiations, and into the trade policy agenda more generally. Thus, not only did many of these countries have to conduct a broad-based consultative exercise pre-Doha, some delegations at Doha included representatives of civil society and others. Moreover, during the course of the discussions leading up to and at the Doha meetings, it became abundantly clear that, to sweeten the deal for the developing countries (and especially the least developed), the WTO's richer members would be expected to deliver—and not just trade-related technical assistance but also market access in textiles and clothing and agriculture.

While these richer multilaterally-oriented countries faced a far more complex calculation of how and why they would stand to benefit from a new round than had been the case in previous launches, and with a pledging session for expanded development assistance looming, they behaved in line with expectations as to how confirmed multilateralists would behave.

What is on tap for Kananaskis

Apart from their usual focus on short-term economic growth prospects, meetings of the Group of Seven/Group of Eight (G7/8) also tend to address topical political and economic issues confronting the global community, including multilateral trade issues and systemic issues of international governance.

---

[4] For Canada, in particular, this was an important development because the Free Trade Agreement (FTA) and its successor, the North American Free Trade Agreement (NAFTA), had largely dealt with the most pressing issues for Canada's business community, namely more secure access to the U.S. market. From a commercial perspective, the main area of interest in the multilateral trade negotiations context was therefore agriculture with Canada joining other like-minded nations in the so-called "Cairns Group", seeking to improve market access and to strengthen disciplines on export subsidies.

While the WTO and the G7/8 are both important for global governance, the contrasts between them could not be greater.

- Whereas the WTO's institutional power derives from its influence over world trade, the G7/8's economic clout comes from influence over global finance, exercised in good measure through its executing agencies, the IMF and the World Bank, both essentially shareholder-run institutions, as well as other instruments of international finance.
- Whereas the WTO is in some ways a rough equivalent to a global town-hall meeting, in which at least those with some economic clout and vested interest have a voice and an equal vote, the G7/8 is the board meeting of the local bank, both exclusive and with no pretence to the principle of one voice, one vote—the Chairman of the Board wields disproportionate influence.
- Whereas the WTO says comparatively little in a positive regulatory sense about the nature of domestic economic management (if already too much in the estimation of some) while providing a well-articulated system of global governance for its area of competence, trade in goods and services, the G7/8 is almost the direct opposite: it tends to support a particular prescription for achieving good economic performance at home[5] while refraining from engaging in what might be seen as direct management of the global economy, leaving that in effect to the market.

If the WTO provides the legal-technical infrastructure for managing global commerce, as some would argue, the G7/8 might be said to provide the "cabinet" meetings of the system of global economic governance.

Against this background, the agenda for Kananaskis has two major issues planned in addition to the routine consideration of global economic growth prospects: fighting terrorism and a G7/8 Africa Action Plan which is to build and expand on the New Partnership for Africa's Development (NEPAD) unveiled at the 2001 G7/8 summit in Genoa.

---

[5] As discussed below, the main elements of this come from the so-called "Washington Consensus" as updated by the G-20's "Montreal Consensus".

More fundamentally, Kananaskis is cast as being about "mainstreaming" governance, both domestic and international. The G7/8 "take" on governance starts with the empirically-based premises that:

- economic growth is key to reducing poverty;
- prudent monetary and fiscal policies and market-friendly reforms are associated with better economic growth;
- open markets for goods and services as well as foreign investment and access to international capital markets constitute essential features of growing economies; and
- investments in education and health care and the creation of adequate social safety nets are needed to provide the basis for equitable sharing of the benefits of growth (and thus to promote political stability and sustainability of reforms).

More recently, attention has been focused on the institutional frameworks that facilitate transactions in a private, contract-based exchange economy—the rule of law and enforcement of contracts, sound economic regulation (especially of financial institutions and markets), and transparent and accountable public management (i.e., absence of corruption) that instils confidence in local and potential foreign investors alike.

The substantive content of this prescription, which may be termed the Washington/Montreal Consensus, is married with procedural elements modelled on those in the NEPAD which emphasize ownership of the policy reforms by the country involved. "Coherence" in this framework means that the various international institutions providing financial or technical support to the developing countries co-ordinate their policies with respect to each client economy:

- the IMF in providing macroeconomic advice and assistance;
- the World Bank through its Country Assistance Strategies;
- UNCTAD/UNDP in supporting domestic adjustment; and
- the WTO in providing trade-related technical assistance to help developing countries exercise the rights and meet the obligations of WTO membership.

The intent is that the international institutions have on offer an internally consistent set of policies that prepare developing countries, and especially the least developed, to meet the

domestic and external challenges of development. Coupled with debt relief and inflows of official development assistance, this would pave the way for expanded inflows of private sector capital to sustain growth and economic development. [6]

Complementing this "supranational" governance framework are the so-called "transgovernmental" forums—networks of agencies or regulatory authorities of sovereign governments that form to address particular issues confronting the global community.[7] An advantage of addressing issues in such forums as opposed to international institutions such as the IMF or the World Bank is that the issues are dealt with by representatives of sovereign nations who are likely to be more sensitive to issues of national interest, attenuating therefore charges that responses are being developed by institutionally–driven, unaccountable international bureaucrats.

While it is clear that major efforts are being made to respond to the criticisms that have been levelled at the approach

---

[6] One currently favoured vehicle to give effect to this approach is the Poverty Reduction Strategy Paper (PRSP) process. PRSPs are conceived as "blueprints" for development and poverty reduction in the least developed countries, as well as being mechanisms for coordinating donor development assistance. These blueprints join the alphabet soup of other strategies/initiatives/programs to deal with poverty, debt and development, including the World Bank Country Assistance Strategies (CAS), the IMF's Extended Structural Facility (ESF) programs, the Heavily Indebted Poor Country (HIPC) initiative and as many others as there are agencies or international meetings on the issues.

[7] One example of a transgovernmental forum is the Group of 20 (G-20), which brings together the Finance Ministers of systemically important countries. The G-20 was formed in the wake of the Asian Crisis to identify policies required to avoid the build-up of financial fragility and to create mechanisms to facilitate working out problems when they do arise. Other examples include the Basle Committee on Banking Supervision that was formed by the Central Bank Governors from the Group of Ten, and the International Organization of Securities Commissions (IOSCO). For a discussion of the role of transgovernmental forums in the system of global governance, see Anne-Marie Slaughter, "Governing the Global Economy through Government Networks" in Michael Byers (Ed.) *The Role of Law in International Politics: Essays in International Relations and International Law* (Oxford: Oxford University Press, 2000).

to global governance, it is substantive success that ultimately confers legitimacy. The fact that there continues to be a sense of crisis concerning global governance thus can be traced to the lack of obvious results from the plethora of action plans, agendas and programs promulgated over the years. In this circumstance, the finger of blame gets pointed everywhere—at the developing countries themselves for failing to implement, at the developed countries for inadequate support (including in terms of market access), and at the policy prescription itself.

In this latter regard, it is hard to miss the circularity in the prescription presently on offer: in order to develop, a country must first put in place the institutional framework of an advanced economy. The reason that global governance policy has reached this point is straightforward: while the model is clear—the vibrant, resilient economy of the United States of America—there is no real understanding of "how to get there from here", where the initial conditions of "here" are often those of a destitute, failed or geographically isolated economy.[8]

The road map of major global governance meetings in 2002

Monterrey, Mexico (18-22 March 2002): a UN conference on *Financing for Development* will consider a draft "Monterrey Consensus" which holds that sustainable development must involve a compact between donor and recipient: donors undertake to mobilize Official Development Assistance and other resource flows and to free domestic resources through debt relief; recipients, meanwhile, commit to "country ownership" of the reforms and "staying the course" on agreed development priorities.

Kananaskis, Canada (26-27 June 2002): in addition to considering economic growth and the struggle against terrorism, G7/8 leaders and finance ministers will consider an Action Plan for Africa.

Johannesburg, South Africa (26 August-4 September 2002): Environment ministers will address questions of sustainable development at the "Rio plus Ten" World Summit on Sustainable Development.

[8] In this regard, it is apposite to note that the United States reached its current position with a historical institutional framework that only gradually evolved into its current form).

Development

While governments in the industrialized countries jumped on the technical assistance/capacity building bandwagon at Doha to get developing countries onside for a launch, they now face the daunting task, as many have noted, of delivering this in sufficient quantity and quality to have a significant impact by the time of the fifth Ministerial when the outlines of the Doha Round are to be finally decided. The questions are twofold: can support on the scale that is needed to make a difference actually be mobilized, and how to avoid raising excessive expectations regarding what is feasible in terms of end results—which is not an inconsequential issue insofar as the assistance envisaged is intended, in part, to provide the developing countries most in need thereof with the capacity to negotiate effectively in the *course of* the Doha Round. The outcome will hinge, in the view of some, not so much on the availability of money[9] as on substantive delivery—the technical assistance and capacity building that is being discussed may go well beyond what the WTO Secretariat and other international agencies have been providing.[10]

---

[9] On March 11, 2002, in Geneva, a total of over 30 million Swiss francs (double the initial target) was pledged to what is known as the WTO Trust Fund for Doha-related technical assistance and capacity building.

[10] It is not entirely clear that everyone has the same understanding as to the meaning of the trade-related technical assistance (TRTA) and the broader notion of capacity building that have been widely promised. These terms certainly include advice and training for developing country officials on the interpretation of the WTO agreements of the sort that is routinely provided by the WTO Secretariat (although the WTO has limited capacity of its own to expand this to any great extent). In addition, there is technical assistance in implementing the agreements, which can include for example help in drafting or adapting statutes or regulations (e.g., to implement the TRIPS Agreement) and training for officials in administering these regulations. This type of activity would be more in the province of the World Bank through programs under the Integrated Framework. Some developing

However, for the developing countries that have bought into the program of trade-led development, the key issue is market access. From this perspective, it was argued, the complex agenda that emerged from Doha is taking the WTO away from trade; it needs to get back to this issue front and centre, if the Doha Round is to be a development round as advertised.

The European Union helped build momentum on market access in the period leading up to the Doha meetings with its "Everything But Arms" initiative, which promised quota and duty free access to all developing country products (although, as some have put it, to many developing countries the initiative would have better been titled "Everything but Farms" since the European Union's farm support programs, including its agricultural export subsidies, were not included).

The United States, for its part, greatly facilitated a launch by moving, as noted above, on some of the major elements of concern to developing countries: showing flexibility on TRIPS against the urging of various domestic interests, including notably the pharmaceutical industry, and taking a chance on opening up negotiations on anti-dumping in the round. At the same time, there was no evident thaw on textiles and clothing, one of the key market access issues.

The dynamic observed at the Doha meetings, with the industrialized countries emphasizing technical assistance and capacity building and the most trade-oriented developing countries emphasizing market opening, poses an important question about how the Doha Round is to be concluded. As was observed, after a good number of years of experience in the WTO, developing countries now "have the trade textbook" and are cognizant of the significance of their vote in a consensus

---

countries would interpret the meaning of capacity building even more broadly to include the development of physical infrastructure to support trade (e.g., ports facilities etc.). Within the civil society, on the other hand, the term capacity building would be held to include support for developing participatory mechanisms to increase the democratic legitimacy of developing country participation in negotiations.

setting.[11] Many of these countries are less interested in "putting development into trade" (which is code language for relaxing WTO implementation requirements for developing countries), and would prefer to take at face value the rhetoric of "putting trade into development", which means more trade through significantly improved market access. Can the industrialized countries deliver?

Finally, there is a large unknown due to the entry into the WTO of China in late 2001. As one of the world's largest trading nations, with interests that to some extent coincide with more general developing country interests (although in some ways not), and with geopolitical clout unmatched elsewhere outside the OECD, China's role in the conduct of the Doha Round remains unclear but potentially of high significance.

TRIPS

In many ways, the pitched intellectual battle that rages about the TRIPS Agreement is at the heart of the debate about global governance more generally in terms of (a) the intrusiveness of international rules into domestic policy space, (b) the pressure for international harmonization, and (c) the implications for democratic processes when rules with domestic distributional consequences are adopted on the basis of, or shaped by, international agreements. It is therefore useful to focus on this particular issue in somewhat greater detail.

There are several general features of the TRIPS Agreement that have put it in the line of fire in terms of governance:

First, the economic literature shows that patent protection as a means of eliciting research is not unambiguously an optimal

[11] Moreover, there is now a flood of advice on offer to developing countries from non-official sources (some civil society organizations have been described as constituting a "virtual secretariat" for developing countries) as well as from the official agencies. While some would question how effective or even desired is the support proffered by civil society organizations, others see such organizations as providing analytical support that strengthens the ability of the developing countries to choose effective strategies and to maximize their negotiating leverage.

approach since it gives effect to its purpose by bestowing market power in the form of a temporary monopoly on those holding patents. It is a well-known result of both economic theory and empirical research that monopolies result in economic inefficiencies (e.g., higher prices and reduced output) compared to competitive markets. Accordingly, to justify bestowing market power on particular firms requires not only a good reason for doing so (in this case stimulating additional research and development) but also the absence of a better alternative instrument (e.g., using subsidies or tax incentives to stimulate research).

In a world where governments typically face fiscal pressures, the market distortions resulting from patent protection tend to be seen as the lesser evil.[12] Nonetheless, this still leaves patent protection subject to an empirical test of whether the dynamic gains to society from research and development that is stimulated by the prospect of obtaining a legal monopoly for an extended period (20 years in the case of TRIPS) outweighs the static costs (which include the costs of implementing a regulatory structure to administer the grant and enforcement of the monopoly regime, insofar as the latter are not fully defrayed by user fees).

Given the complex considerations, in order to achieve optimal outcomes, nations must carefully calibrate the length of time for which the ability to obtain monopoly rents is conferred, balancing the potential gains in terms of greater incentives for research against the costs. Since there is no reason to expect that a balance that works for one industry in one country (e.g., health-related products in the United States) will be equally appropriate for other industries or other countries (e.g., food-related products in large population developing countries such as India or China), the deployment of this technique in an

[12] As was pointed out at the conference, the distortions include as well those due to the use of patents to block innovation by others.

internationally standard manner is problematic on *a priori* grounds.[13]

Second, it has been argued that TRIPS was implemented without the type of understanding of its consequential effects that would be desirable in a public policy process. For example, critics now point to the fact that the availability of monopoly rents for certain approaches to problems (e.g., patentable drugs in the case of health problems) distorts the direction of research away from techniques that do not lead to patents, introducing spillover distortions into various areas of economic and social activity. As well, the ability to reap monopoly rents on research into diseases that afflict developed countries distorts research choices vis-à-vis diseases that afflict much larger number of people in the developing world where there is no effective demand to pay the monopoly rents. Doubts about over-emphasizing commercial approaches to research activity are also raised by the evidence of very good returns to non-commercial research and development in agriculture. Finally, there is the fact that sometimes patents are sought for traditional knowledge—i.e., in instances where there is no gain in research at all and the purpose of the patent is in effect to enclose an intellectual commons. Such considerations raise the question of what is a socially efficient research framework.

Third, like tariff changes, patent protection redistributes income. However, unlike tariffs cuts, which redistribute income amongst producers based on competitive grounds and more broadly from producers to consumers by reducing producer rents and enlarging consumer surplus, patent protection redistributes income from consumers to producers, enlarging producer rents and reducing consumer surplus. Accordingly, while the population at large (or at least consumer activists) may be willing to cut trade ministers considerable political economy slack for traditional trade policy, which has allowed the presentation of negotiated outcomes of trade rounds to national legislatures as untouchable *faits accomplis,* there is no

[13] Notwithstanding this point, the Patent Harmonization Treaty, it was pointed out, is moving even faster in this same direction.

such willingness to accommodate the negotiation of rules such as TRIPS.[14]

Fourth, there are various problematic aspects to the inclusion of TRIPS in a trade agreement including, *inter alia*, the internationally asymmetric outcomes from the TRIPS agreement (gains for developed countries and costs for developing countries); and regime inconsistency (private rights for genetic resources under TRIPS versus sovereign ownership of the same asserted by the Convention on Biodiversity).[15]

For all these reasons, the TRIPS Agreement represents a very dubious salient towards a regime for democratic global governance—and this is quite apart from the moral issues raised because of the threat of legal action against compulsory licensing of HIV-AIDS drugs by developing countries, which were put aside (at least to all appearances[16]) at Doha.

---

[14] More generally, it was observed that, insofar as the attack on the WTO stems from the fact that it favours the private interest over the public interest, then something has seriously gone wrong, since the original GATT expressly suppressed private producer interests in favour of expanding the public interest, in particular by reducing producer rents and expanding consumer surplus!

[15] For a fuller discussion of the trade-offs and issues surrounding the TRIPS agreement see Keith E. Maskus, *Intellectual Property Rights in the Global Economy* (Washington DC: Institute for International Economics, 2000).

[16] The extent to which the declaration resolves the issue remains subject to debate. It was observed that, even though TRIPS may not be enforced through the WTO, the fact that most governments, most of the time, will adhere to their formal commitments means that TRIPS will be *de facto* enforced. Moreover, in terms of the scope of the flexibility built into the agreement, it was suggested that those providing technical assistance to developing countries tend to interpret this flexibility narrowly, further increasing the likelihood that it will be applied narrowly. That being said, it was also pointed out that the World Bank has been highlighting the flexibility in the agreement to its developing country clients in its publications. In the end, it may be up to the dispute settlement mechanism to establish what the international regime is in *de facto* terms, in particular with respect to the boundaries that will apply to the flexibility indicated in the political declaration (i.e., when is a health situation an emergency for purposes of TRIPS) and or in areas where controversies have yet to surface.

At the same time, there is the *realpolitik* issue that the TRIPS Agreement poses: arguably, there would have been no Uruguay Round outcome without it, since it was a major factor in mobilizing U.S. private sector support for the round. The technical analysis of the agreement, or lack thereof, did not enter into the political equation.

As to the narrow question of the future of the TRIPS Agreement itself, it was argued that the array of interests that led to TRIPS being implemented remains to a good extent in play. Indeed, as was observed, at Doha, the TRIPS-related issue that was being actively discussed had to do with *expanding* it to include geographic indicators, with the *demandeurs* being not U.S. multinationals but developing countries seeking to create rents for themselves.[17] While this suggests that TRIPS may be generating new constituencies, which in turn would militate against its demise, some see it at risk of being weakened, unless market access on agriculture and textiles and clothing is forthcoming. At the same time, the fact that the United States is implementing intellectual property in its bilateral free trade agreements points to an alternative *de facto* global regime emerging from a patchwork quilt of bilateral and regional agreements.

Services

The major governance issue posed by trade in services under the GATS derives from the fact that this agreement applies international disciplines to domestic regulations and to services that are delivered by the public sector in some countries. These concerns may be articulated as follows.

---

[17] It is more than a little alarming that the commentary on this issue has tended to emphasize that this shows that developing countries might indeed find benefits in TRIPS rather than pointing out the Pandora's Box of rent seeking which TRIPS has introduced into the bosom of the international trade regime, including in cases where redeeming benefits in terms of research and development are not even remotely at issue.

Insofar as services trade disciplines rule out regulations that are presently considered to be optimal, constrain movement to regulations that might be optimal in the future (through *de jure* or chilling effect), or prevent the trial and error experimentation that may be required to identify an optimal regulatory regime, their existence is problematic from a theoretical economic welfare perspective.[18] The generally poor state of knowledge concerning the impact of changing regulations in developed countries, and the complexities involved in understanding the effect of the GATS regime,[19] heightens concerns for many about entering into binding commitments; the far greater lack of knowledge about these issues in developing countries escalates these concerns when services trade disciplines are extended beyond the industrialized countries.

Meanwhile, introducing private sector service suppliers into areas where public sector supply has been the norm (sometimes in the form of public monopolies), while in theory welfare enhancing in economic efficiency terms due to de-monopolization, might result in trade-offs with non-efficiency-related public objectives that are not considered to be desirable

---

[18] One observation was that, in some areas, regulatory regimes develop on a "follow the leader" basis. California, for example, tends to play this role in environmental regulation while the U.S. Securities and Exchange Commission tends to play this role in securities regulation. Insofar as the bias within the WTO setting is against outliers in regulatory regimes, it would tend to "stop the leader", and thus tend to arrest regulatory development.

[19] The GATS applies disciplines in some cases to non-discriminatory measures as well as to discriminatory measures, complicating determination of what is and what is not subject to, or potentially subject to, an international trade in services discipline. In a similar vein, regulations that are nominally non-discriminatory may be subject to disciplines if their effect is more onerous on foreign services suppliers – a *de facto* test. Technical difficulties in interpreting certain drafting within the GATS that have been identified by the WTO secretariat add to this concern. Indeed, the inclusion of tests for regulations such as "not more burdensome than necessary" which have yet to be subjected to jurisprudence make this agreement, in the view of some, a "labyrinth of uncertain language".

in overall public policy terms.[20] While the GATS provides exclusions for government-provided services, how narrow or wide the exclusion is depends on interpretation (since many, if not most, government services involve an admixture of private supply, a narrow interpretation of the exclusions could give the GATS wide application).

Finally, it was argued, the fact that regulatory measures might be subject to dispute resolution could place the Dispute Settlement Body in the position of domestic regulatory oversight in areas that seem quite remote from trade (e.g., domestic water quality measurement, land-use planning and zoning restrictions[21]) and thus well beyond what would appear to be reasonable.

Since a good portion of the basic services provided by local governments might be potentially attractive to private sector service providers, and thus possibly to foreign service providers, the governance issues in these areas are, in the view of some, quite immediate. This concern is heightened by the tight three-year target for completion of the Doha Round negotiations (which in the view of some creates a false sense of necessity that militates against the thorough public policy scrutiny that such commitments require).

Countering these various apprehensions, and indeed in good measure *because* of these apprehensions, there are several features of the current WTO trade in services regime that mitigate concerns:

- the positive list approach in which commitments are made, coupled with the fact that governments, especially in the developing world, have been cautious about entering into commitments;

---

[20] It was noted that, in one instance where water supply was privatized, an international dispute erupted when the foreign investor shut off the supply of water to those who could not pay.

[21] One example that was cited where a trade dispute could involve zoning regulations would be entry of a "big-box" retailer into a particular neighbourhood.

- the relaxed manner in which the Appellate Body has tended to interpret Article XX grounds for exceptions,[22] coupled with the Doha Declaration's affirmation of the right to regulate which strengthens the hand of the Appellate Body in upholding domestic regulation in politically sensitive cases; and
- the fact that retreat from commitments requires negotiations only with principal suppliers, not with the entire WTO membership.

With the trade in services regime still very young and having undergone little development, it remains difficult to foresee how serious the potential problems will turn out to be. Nonetheless, there are sufficient grounds to suspect that movement on services liberalization will be cautious (not least because well-developed sector-specific base cases such as provided by the Telecoms Reference Paper for that sector are lacking in other sectors) and that services disputes will be difficult for the WTO to manage.

Agriculture

Although there is widespread agreement that agriculture is the area in which trade liberalization stands to yield the greatest commercial or economic gains,[23] agriculture also remains probably the most difficult subject for trade policy. Little progress was made between the official launch of renewed multilateral negotiations in 2000 (as had been pre-committed in the conclusion of the Uruguay Round) and the Doha meetings, notwithstanding the fact that over 120 proposals had been put

[22] Article XX of the GATT, entitled *General Exceptions*, provides that the Agreement shall not be construed to prevent the adoption or enforcement of measures related to a specific list of grounds, including for example protection of public morals, national cultural treasures or human, animal or plant health or life.

[23] For a review of the literature on this point, see Chapter 3 in this volume, John M. Curtis and Dan Ciuriak, "The Nuanced Case for the Doha Round".

forward. This supports the view that broader trade-offs are essential for forward movement in this area.

From a governance perspective, the agricultural trade negotiations highlight several issues.

First, there is the central role in shaping the Doha outcome played by the European Union's insistence that its own internal reforms to the Common Agricultural Policy *not* be pre-judged in any way by the multilateral trade negotiations.[24] The tough negotiations and the sophisticated language used to present the outcome is indicative of the scope for multilateral rules to impinge on domestic rulemaking—and the result is indicative of the privileged position of the larger economies in determining the outcome of trade rounds.

Second, there is the complicated issue of "non-trade" concerns.

Third, there is the conflict between the commitment made by the industrialized countries to open up markets for developing country agricultural exports and the entrenched position of agricultural producers in domestic politics within the advanced countries.

Fourth, the pressure on family farm incomes is undermining support for trade liberalization in agriculture even in successful exporting countries. This may have less to do with trade liberalization *per se* than, as was argued at the conference, with the mergers and take-overs that have increased corporate concentration in various links in the agri-food production chain, including upstream equipment/input suppliers and downstream processors/ distributors.

Trade-related Issues

The intersections between trade and other policy issues that are affected by trade and/or in their turn impact on trade policy are the focus of much of the concern about trade policy and especially about further liberalization. The rules that are to

[24] This was at the crux of the issue about the interpretation of the words "with a view to" elimination of export subsidies.

govern traffic at these intersections remain to be clearly set out—are we talking about an overpass, an underpass, a four-way stop or a two-way stop? While public support for trade is broad (this is the case in Canada but also elsewhere), so is concern about how these intersections are regulated.

Resolving the interaction between the WTO agreements and the Multilateral Environmental Agreements (MEAs) is one important task that will be undertaken in the Doha Round.[25] However, for environmentalists, this is but the tip of a much larger iceberg of issues that remain to be adequately addressed.[26] And, in the view of some, the attitudes of environmentalists are hardening.

On trade and labour, the International Labour Organization has been pushed to increase its profile on international labour issues in order to relieve the pressure on the WTO. While trade and labour issues thus had little profile at Doha, it was suggested at the conference that the position of labour is also hardening.

---

[25] MEAs are agreements between states which set out principles which parties are to respect when considering actions which affect a particular environmental issue ("soft law") or which specify legally-binding actions to be taken to work toward an environmental objective ("hard law"). The major MEAs are the Convention on Biological Diversity (CBD), the Framework Convention on Climate Change (FCCC), the Montreal Protocol on Substances that Deplete the Ozone Layer (Montreal Protocol), the Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES), the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal (Basel Convention), and the United Nations Convention on the Law of the Sea (UNCLOS). Some of the important "soft law" agreements include the Rio Declaration on Environment and Development, Agenda 21, and the Forest Principles.

[26] These include the larger questions concerning the environment and the economy such as failure to account for resource depletion in measures of economic output, the validity in broader public policy terms of economic theories that underpin trade (e.g., comparative advantage), and the issue of regulation of transnational corporations. This set of issues will get a hearing at the Rio-plus-ten meetings in Johannesburg, the third major leg of the 2002 global governance tour from Doha to Kananaskis to Johannesburg.

Conversely, for the corporate sector, Doha was much less interesting than Punta del Este, where the Uruguay Round was launched. Investment is not that big an issue any more, perhaps because the web of bilateral and regional agreements that contain provisions dealing with investment have effectively dealt with pressing issues. Similarly, the corporate sector has little concern about competition policy within the multilateral framework, provided only that the United States and the European Union can sort out their bilateral concerns.

The Competition from Regionalism

The ongoing activity towards deeper regional economic agreements remains a major issue for the multilateral system. The WTO's disciplines on regional agreements (Article XXIV, which requires most importantly that substantially all trade be covered by a preferential trade regime for it to be consistent with multilateral obligations) remain untested.[27] In good measure, it was suggested, this reflects the clouded meaning of Article XXIV: does it cover substantially all of existing trade (which may be quite small) or substantially all potential trade (which might be much broader).

Concern about regional trade agreements has generally been muted because of the general consensus that, on balance, the trade that they create exceeds, often substantially, the trade that they divert. On the other hand, the deepening of trading blocs weakens the apparent significance of the multilateral system to those who actually take part in trade—businesses—even though multilateral liberalization is vital in minimizing the distortionary effects of regional pacts by squeezing the available margin of preference that they can provide.

Moreover, for developing countries, the jury must remain out on whether regional pacts help or hinder. East Asia, which

[27] Many regional trade arrangements have been notified to the WTO in accordance with obligations to which members are subject; however, to date, there has not been a single ruling concerning whether any particular trade arrangement is consistent with Article XXIV.

is the region that has done best in integrating into the global economy through trade, is conspicuous in terms of having far fewer regional trade agreements than Latin America or Africa (which curiously has the most).

Nonetheless, there appears to be considerable interest in developing a bloc in East Asia (for reasons that may have more to do with the Asian Crisis than with trade policy *per se*). Meanwhile, in the Western Hemisphere, the Free Trade of the Americas process is due to conclude at the same time as the Doha Round, in 2005, setting up a horse race of no small consequence for the role of the multilateral system in "delivering the goods" on trade.

The WTO as an Institution of Global Governance

One important strand in the controversial weave of global governance today is the role of supranational institutions.

In the view of some, the WTO is a member-driven organization through which duly constituted governments voluntarily enter into binding international commitments for mutual gain. The WTO is kept deliberately small in order to ensure that a strong role is played in national capitals.

In the view of others, the idea of the WTO as a member-driven consensus organization is a fiction; some who cleave to this view see the WTO as constituting yet another supranational institution with an unelected bureaucracy that wields considerable influence over public policy in many countries through its control over inside information (as reflected by the lack of "external transparency" in WTO affairs), its proactive role in interpreting the agreements,[28] its advocacy of liberalization and most importantly through the judicial power of the dispute settlement mechanism. This independent power

[28] Developing countries, which tend to be on the receiving end of WTO Secretariat advice and assistance, face some difficulties in this regard. While they may be suspicious of the interpretations of the agreements offered by WTO insiders because the institution's advocacy has called its objectivity into question, it remains difficult to know what advice one should then trust.

is to some extent negated by the fact that the WTO is a leaky organization (attributed by some to the presence of reasonable people on the inside) and can be pushed back by members.[29] Nonetheless, as was argued, since the WTO does not derive its power formally, it is difficult for this power to be transparently subjected to discipline. It was also observed that, in India, the WTO is paid far more attention than is accorded the IMF or the World Bank.

Many of those who see the WTO as inordinately weak argue that it should be strengthened, armed with larger budgets and more personnel, and granted greater executive powers to deal with, at a minimum, lower-level administrative decisions and technical interpretations. Conversely, those who see the WTO as too powerful would like to see its influence cut back to increase its democratic legitimacy. It is not clear that there is a feasible middle ground.

While the WTO of presently 144 members is a radically different organization than the original GATT of 23, its decision-making architecture has not changed. Nor is it likely to change any time soon because the consensus format is a major source of power within the institution for the smaller members. Equally importantly, institutional reform of the WTO is not a high priority for the United States.

The WTO thus remains without a management committee. As well, it lacks a policy forum in which to debate divisive issues, something which it did have prior to the disbandment of the Consultative Group of 18 (CG18). Finally, a way to meet the developing countries' concern about not being fully part of the negotiating process has not yet been sorted out.

At the same time, the proposals put forward at Doha on "external transparency" were greeted with yawns, reflecting perhaps a perception that the anti-globalization demonstrations had passed their peak (a perception which many in civil society

---

[29] The Dispute Settlement Body (DSB) was indeed forced to disinvite *amicus curiae* briefs in the course of a dispute when members called a special session of the General Council to protest what they saw as the DSB deciding an issue that members had left undecided in the Uruguay Round

would argue is false). Moreover, there is no clear response to the concerns that are being raised by the intrusive nature of WTO rules in the services sector (where trade disciplines have the potential to influence the substantive content of domestic regulation and possibly even to result in WTO dispute resolution panels making rulings on substantive domestic regulation, for which many would argue WTO panels have neither the requisite expertise nor, more fundamentally, the legitimacy). A resolution to the broader question of democratic legitimacy that exercises the civil society movement is thus also not yet in sight.

Conclusions

A failure to launch a round at Doha would have been very damaging for global governance. There are alternative avenues that nation-states can take in addressing pressing trade-related problems—the WTO is not after all the only game in town. However, bilateralism and regionalism in the trade policy arena carry their own risks.

While the successful result at Doha was therefore of much importance, it is not clear how properly to characterize this success—a round or an agenda. Indeed, the Doha Declaration has no equal in terms of the skill with which it deployed "constructive ambiguity" to paper over fundamental divides. The work program, regardless of how characterized, will be decided at the fifth Ministerial Meeting of the WTO in Mexico in 2003. Accordingly, it is impossible at present to predict the outcome of the success at Doha.

Nonetheless, there is great significance in the symbolism that is invoked in the Doha Declaration (in particular, the persistent refrain of special and differential treatment for developing countries) and in the fact that the United States and the European Union conspicuously "wooed" Africa before and during the meetings. By contrast, the South played no great role at Punta del Este. The importance of development issues in the current work program cannot, therefore, be emphasized enough.

At the same time, delivery by the industrialized countries will not be easy: the areas where they would like the emphasis to be (technical assistance and capacity building) often involve long-term institutional change and results can be difficult to measure, while the areas which matter most to developed countries (market access on agriculture and textiles and clothing where developing countries face tariff walls that are often prohibitive) are where the economic adjustment and associated political pain in the industrialized world lies. Moreover, there remains a huge gap between the amount of Official Development Assistance that is needed to meet promises and the amount that has been identified.

From the perspective of governance issues *per se*, the future of the WTO appears to be troubled. The erosion of the buffer zone between domestic and international policy space that has been underway since at least the Uruguay Round (and to some extent the earlier Tokyo Round) is to be accelerated through the push for further services trade liberalization in the Doha Round. Whether the WTO, and especially the Dispute Settlement Mechanism, can cope with the added burdens is not clear. Moreover, it remains to be seen how the WTO will function as a negotiating body with a membership of 144 that now includes a wild card of unknown significance in the form of China.

Finally, there is the larger issue of international coherence, including not only the trading system but the international financial regime of exchange rates and capital flows. Insofar as this issue is on governments' radar screens, it is in terms of the institutional linkages and interactions involving the WTO and the Bretton Woods institutions. The substantive aspect (the impact on the trading system of over-shooting exchange rates and volatile capital flows), however, is not being dealt with—and indeed, has not been taken up since France voiced concerns about the interaction between exchange rates and the trading regime in the aptly named "FOGS" process (the acronym was for the formally constituted Uruguay Round Negotiating Group on the Functioning of the GATT System, which amongst other goals was to establish better links to the Bretton Woods institutions).

The global economy has changed. The need to change the approach to global economic governance seems apparent to all. Yet how to do it is contested as never before. It seems apt in these circumstances to recall the words of one Niccolo Machiavelli: "...there is nothing more difficult to arrange, more doubtful of success, and more dangerous to carry through than initiating change in a state's constitution."[30] The road from Doha to Kananaskis and beyond can well be expected to be bumpy.

[30] Niccolo Machiavelli, *The Prince* (Penguin Books, 1973): p. 51.

The Role of Contextual Factors in the Launching of Trade Rounds

John M. Curtis*

Introduction

The broader economic and foreign policy context is often overlooked by those involved in trade policy. Today, much of the trade policy literature and policy discussion can be characterized as instrumental, legal-technical or procedural in nature. The focus tends to be, for example, on dispute settlement issues, the functioning of the WTO as an institution, or how to deal with the "built-in agenda" or the "Singapore issues".[1] Another stream of trade policy discussion concerns itself with the grassroots/business/political support (or lack thereof) for liberalization and/or how to deflect public pressures on the trade agenda coming from the anti-globalization camp, including by developing economic analysis of the likely impacts

* John M. Curtis is Senior Advisor and Coordinator, Trade and Economic Policy, Department of Foreign Affairs and International Trade. This paper was prepared in a personal capacity. It has benefited from the views of departmental officials at a "brown bag lunch" session where an earlier version was presented, as well as from comments and drafting suggestions from Dan Ciuriak. The views expressed are those of the author and are not to be attributed to the Department of Foreign Affairs and International Trade, or to the Government of Canada.

[1] For the non-cognoscenti, the "built-in agenda" refers to the liberalization initiatives, including the launch of negotiations on agriculture and services at a set time, that were agreed as part of the Uruguay Round – in a sense, the unfinished business of that round. The "Singapore issues," meanwhile, refer to the so-called "new" trade policy issues such as competition policy and investment, the inclusion of which in the multilateral trade framework remains controversial and which accordingly remain in the limbo of the trade negotiation world – under study by a working group.

of trade liberalization. The result is a certain "inwardness" in the trade policy literature.

Perhaps as a reflection of this, comparatively little has been written to date about the role of contextual factors in explaining: (a) why trade liberalization happened in the first place; (b) when and at what pace it happened; and (c) why it took the form that it did. To shed light on these questions, this chapter examines the economic and political context in which trade rounds have been launched and negotiated.

The analysis in this chapter contrasts the early postwar rounds with the rather unique Dillon Round, which marked the beginning of a transition, and with the later "named" rounds—the Kennedy, Tokyo and Uruguay Rounds—which completed the transition to a more complicated management of international trade. Based on this review, the analysis attempts to shed light on why a round failed to emerge from the WTO Ministerial in Seattle in November/December 1999, and why one did emerge from Doha in November 2001.

The Early Rounds

To some extent, the inwardness of trade policy literature reflects the habits of minds fashioned by the way the early GATT rounds, listed in the panel below, unfolded.

Early GATT Rounds[2]	Dates
Geneva Round	April to October 1947
Annecy Round	April to August 1949
Torquay Round	September 1950 – April 1951
Geneva Round	1955-1956

As can be seen, these earlier rounds were launched in fairly rapid succession. There is little to indicate that they were driven

[2] These rounds were not actually "named"; that practice began with the Dillon Round. Nonetheless, the first four rounds have come to be referred to by the name of the locale in which they were negotiated: Geneva, Annecy in the French Alps, and Torquay in the United Kingdom.

by anything other than the interests and concerns of trade ministers pursuing their own particular mandates to roll back the highly destructive protectionism of the interwar era.[3] The tariff reductions negotiated in these rounds were accompanied by the dismantling of quantitative limits on imports and exports and various payments impediments that hampered international commerce. By the time the agreements arising from these four rounds were completed, the average weighted tariff in the major industrialized countries had fallen to about 15 percent.[4]

While the strength of the mandate given trade ministers in the early postwar years was founded on the reaction against the beggar-thy-neighbour protectionism of the interwar period, their work was greatly facilitated by the nature of the early postwar international institutional framework. It will be recalled that this was the era of the so-called "club" system, which Keohane and Nye have described as follows:

> "Beginning with the Bretton Woods conference of 1944, key regimes for governance have operated like 'clubs.'

---

[3] It is important, however, to recall the Cold War origins of the GATT. As U.S. Trade Representative Robert Zoellick reminds in a recent speech: "The autumn of 1947 was a time of both anxiety and nascent opportunity. Amidst the devastation after World War II, the United States was beginning to frame a political, security and economic strategy for what became know as the Cold War. Earlier in the year, President Truman had announced a doctrine about using economic and financial aid to support free peoples resisting armed minorities operating through networks of subversion. In June, Secretary of State Marshall had launched a comprehensive program for the 'revival of a working economy in the world so as to permit the emergence of political and social conditions in which free institutions can exist.' It was clear to those individuals meeting in Geneva 54 years ago .... that trade was inextricably linked to recovery, development, and security." See: Robert B. Zoellick, "The WTO and New Global Trade Negotiations: What's at Stake" (mimeo). While the membership of the GATT was shaped by the political security context, within the GATT, the straightforward task was dismantling trade barriers amongst the parties.

[4] As reported in Bernard M. Hoekman and Michel M. Kostecki, *The Political Economy of the World Trading System: From GATT to WTO* (Oxford: Oxford University Press, 1996), p. 18.

> Cabinet ministers or the equivalent, working in the same issue-area, initially from a relatively small number of relatively rich countries, got together to make rules. Trade ministers dominated GATT; finance ministers ran the IMF; defense and foreign ministers met at NATO; central bankers at the Bank for International Settlements (BIS). They negotiated in secret, then reported their agreements to national legislatures and publics." [5]

This was not a pure model of course; finance ministers were necessarily involved in trade policy decisions, because of the revenue reduction that tariff cuts implied. But by and large, other ministers were effectively excluded by the device of holding negotiations under the shroud of diplomatic secrecy and presenting the results to domestic Cabinet colleagues as largely unalterable *faits accomplis*.

One reason that this was possible is that the early rounds restricted themselves to dealing with easy-to-understand border measures—for the most part, the tariff. Broader issues "behind the border" were not tackled, and other ministries therefore did not need to get involved. By the same token, they did not clamour for such access either. As Keohane and Nye argue:

> "The club model was very convenient for officials negotiating agreements within issue-areas, since .... officials in other government bureaucracies, and in international organizations defined as working in different issue-areas, were excluded from the negotiations. Environmental, labour rights, and finance officials did not participate in a regular basis in WTO

---

[5] See, Robert Keohane and Joseph Nye, "The Club Model of Multilateral Cooperation and the WTO: Problems of Democratic Legitimacy", paper delivered at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium*, June 1-2, 2000, John F. Kennedy School of Government, Harvard University. http://www.ksg.harvard.edu/cbg/trade/keohane.htm .

negotiations. In general, they did not object to their exclusion."[6]

There was, accordingly, little reason to look for factors beyond trade policy itself for the rationale for new trade negotiations.

The Dillon Round (1961-1962)

The Dillon Round[7] stands out as something of a *sui generis* event. This round started out largely to settle a number of issues related to the formation of two preferential trade arrangements in Europe: the European Economic Community (EEC) and the European Free Trade Association (EFTA).[8]

The negotiations undertaken in the context of this round were marked by a weak U.S. negotiating authority. This reflected, in the first instance, the limitations of the 1958 extension of the Reciprocal Trade Agreements Act.[9] More deeply, it also seems to have reflected a rather complacent attitude toward trade policy pressures. For example, the Haberler Report, issued in 1958 by a number of eminent

---

[6] Ibid.

[7] The round was named for C. Douglas Dillon who, as the U.S. Undersecretary of State in the Eisenhower Administration, suggested its launch. Dillon later served as Treasury Secretary in the Kennedy Administration.

[8] Specifically, the negotiations were intended to resolve claims arising under GATT article XXIV:6 with respect to the just-created EEC, as well as to examine the Article XXIV consistency of the EEC and the EFTA which had been established by the West European countries that had chosen not to join the EEC. Both exercises ended inconclusively, setting the precedent for future such investigations of consistency of regional free trade arrangement with Article XXIV, which specifies the conditions under which such arrangements comport with multilateral rules.

[9] For a discussion of the context, see Michael M. Hart, *Fifty Years of Canadian Statecraft: Canada at the GATT 1947-1997* (Ottawa: Centre for Trade Policy and Law, 1998), p. 74.

academic economists, [10] concluded that the GATT process had successfully reached the end of postwar reconstruction. This complacency was echoed in the new Kennedy Administration's attitudes toward trade. For example, the 1961 Economic Report of the President, issued shortly before the Dillon Round was engaged, limits its discussion of international trade issues and of the upcoming Dillon Round to one paragraph, which noted that:

> "...discrimination against United States exports has diminished very substantially; the major remaining quantitative trade restrictions on United States exports are against agricultural products, particularly in Western Europe. Foreign restrictions on capital transactions, however, continue to be considerable. The United States government expects that there will be continued progress in the dismantling of restrictions on world trade and payments. In particular, the great economic strength of the countries belonging to the European Economic Community and the European Free Trade Association should facilitate a significant lowering of tariff barriers during the forthcoming Geneva GATT negotiations."[11]

The result of the Dillon Round was to some extent a step backward in trade policy terms: a successful EEC effort to unbind many tariff concessions in agriculture previously made by individual member states. The United States, for geopolitical reasons related to the Cold War, acquiesced in this effective backsliding from earlier progress on trade liberalization over the protests from Department of Agriculture. [12]

---

[10] The panel, which was chaired by the distinguished economist Gottfried Haberler of Harvard, was set up by the GATT in 1957, shortly after conclusion of the fourth round of GATT negotiations. See *Trends in International Trade,* GATT, 1958.

[11] See *Economic Report of the President*, January 1961, p. 40.

[12] The geopolitical rivalry with the Soviet Union was, in fact, peaking with the successful launch of Sputnik, the Cuban missile crisis and Khrushchev's heel-thumping growth challenge at the UN. The need for a

Trade policy *per se* clearly did not rank high on anyone's priority list at this time. For example, at the beginning of 1963, shortly after the conclusion of the Dillon Round, the U.S. perspective on the international economic landscape, as summed up in the Economic Report of the President released in January of that year, continued to suggest a certain complacency. The chapter on the international economy opens as follows:

> "The international economy has undergone a remarkable transformation in the past decade. For many years after World War II, import quotas, discriminatory trade practices, and exchange restrictions on all forms of international payments characterized the bulk of international transactions. Though further progress needs to be made, much of this restrictive legacy has now been swept away." [13]

There is no sign here of American concern over the state of the trading system or the failure of the Dillon Round to advance trade policy *per se*. This, coupled with the predominant role of geopolitical considerations in shaping the outcome of the Dillon Round, is a clear sign of a more important role emerging for broader contextual factors. This marks the Dillon Round as the beginning of a transition phase in the development and implementation of trade policy.

It is, however, rather prophetic that the above-cited passage continued with the following comment on developments in the international payments area:

> "This transformation culminated in the formal acceptance by the major European countries in early 1961 of the

---

strong Western Europe as a bulwark against communism overrode other considerations at this time.

[13] *Economic Report of the President* (Washington: Council of Economic Advisors, 1963), p. 91.

currency convertibility requirements of the International Monetary Fund. It is a notable achievement and has far-reaching implications for the U.S. economy and U.S. economic policy."[14]

Indeed, the Economic Report of the President was right on both counts: payments issues did constitute the major international issue of the 1960s and were to play an important role in shaping the course of trade policy.

The Kennedy Round (1963-1967)

There are two hints that trade policy during the Kennedy Round had entered a new political-economy space. First, the popular name adopted for the round was that of President Kennedy, suggesting that the broader economic context was at play. Second, the round took substantially longer to negotiate than earlier rounds.

While the Kennedy Round resulted in important tariff cuts, it is an interesting question as to why it took until 1963 to launch a serious tariff-cutting exercise. In reality, only two of the five preceding rounds resulted in major tariff cuts: one of these had occurred prior to the formation of the GATT, in the first negotiation in Geneva in 1947, and the second in Torquay in 1951-1952. The negotiations in Annecy and the second round of negotiations in Geneva both produced disappointing results, as did the Dillon Round. Meanwhile, a clear-cut trade policy agenda had long been in hand from the Haberler Report of 1958, which had made recommendations in respect of three theses that the panel of experts had been asked to examine. Specifically, the Report recommended:

(a) shifting to a systemic approach to tariff cuts to replace the product-by-product approach;
(b) addressing trade in agricultural goods; and

[14] Ibid., p. 91.

(c) giving developing countries greater flexibility to use trade restrictions to promote infant industrial development, particularly key industries that would spur further industrialization, to address balance of payments issues (which they would be more likely to face), and more generally to "turn the international terms of trade ... in [their] favour."

It is always instructive to look to the "dog that didn't bark." With average tariffs still fairly high at the time and many other issues to be addressed, the long hiatus in significant forward movement on trade policy is not easy to explain.

As well, the fact that two of the Haberler recommendations, trade in agriculture and developing country issues, are still featured prominently in the just-launched Doha Round is silent testimony to the witch's brew that these two issues have constituted for trade policy over the many decades since Gottfried Haberler and his co-panellists issued their report.[15]

By the same token, the fact that the Haberler Report agenda was firmly engaged in the Kennedy Round suggests that circumstances had changed to end the hiatus of the late 1950s

---

[15] It is interesting to recall here why agriculture was largely excluded from the original GATT. As Philip Trezise notes: "When GATT was written in 1947, it was recognizably an American document, drawn in substance and to a considerable extent in language from drafts written in the Department of State for the commercial policy chapter of the proposed International Trade Organization. The provisions for agricultural trade substantially exempted from GATT discipline the U.S. farm programs inherited from the New Deal. Article XI, the prohibition of import quotas, does not apply to agricultural commodities subject to production or marketing controls. Article XVI, which frowns on trade-distorting subsidies in general, allows export subsidies on primary products, with the vague injunction that such subsidies capture no more than an 'equitable' share of trade. These openings were widened in 1955 when Congress forced the Eisenhower administration to obtain a sweeping waiver of GATT rules for any article produced under a U.S. farm program." See Philip H. Trezise, "The Uruguay Round: High Hopes, Hard Realities, and Unfinished Business," Brookings Institution, Volume 14, Number 1, Winter 1991. The difficulties in advancing agricultural sector liberalization may to some extent flow from this "original sin" on the part of the prime mover of the original GATT.

and early 1960s. In retrospect, the contextual factors that would drive and shape the Kennedy Round were already incubating during the Dillon Round: these were the emergence of persistent balance of payments problems in the United States and elsewhere, and the reactions of governments in devising creative, inside-the-border solutions to tough border problems. Secondly, geopolitical rivalry was escalating and U.S. geoeconomic considerations, which were never far from the surface in any event, coalesced to give impetus to trade talks.

The Balance of Payments Pressures

In contrast to what is often considered to be a "mercantilist" perspective of modern trade policy (as reflected in the importance attached to maintaining trade and current account surpluses), the principal U.S. concern in the 1960s was the flip side of the consistent current account surpluses that it had run following WWII—namely, the capital account deficits and the still broader balance of payments deficits that had served to transfer large quantities of gold and liquid dollar reserves to the rest of the world. [16]

---

[16] It is worthwhile to recall the theoretical views that underpinned policy at that time, and more particularly, what matters were perceived as policy "problems." As Harry Johnson wrote in 1962: "In the past 20 years, there has been a great deal of change in the theoretical approach to balance-of-payments problems and the mechanism of adjustment. This has been associated, on the one hand, with the Keynesian revolution, which led to the formulation of theories in terms of disequilibrium rather than equilibrium and, on the other hand, with the prevalence of balance-of-payments problems particularly in the postwar period. Very briefly, the change has been from the idea of a mechanism of adjustment to the idea of the balance of payments as a policy problem." In the context of the Bretton Woods system of fixed exchange rates, the "balance of payments problem" facing the United States was that its domestic currency supply might become insufficiently backed by a reserve of gold or foreign exchange. While balance of payments problems thus formulated were understood to be fundamentally monetary phenomena, the path to their resolution did not necessarily lie in the financial domain, especially if the repercussions there were undesirable. See: H.G. Johnson, *Money, Trade and Economic Growth* (Great Britain: Unwin University Books, 1962), p. 16.

The Kennedy Administration, which took office early in 1961, thus started its term with the dollar under pressure.[17] While acknowledging the importance of the capital outflows in helping to rebuild reserves in the major European countries and thereby providing them greater flexibility to promote economic growth and to reduce restrictions on international transactions, the United States began to have concerns and to give voice and effect to these concerns. As the 1963 Economic Report of the President noted:

> "These U.S. payments deficits have persisted beyond the point where they improve the distribution of the world's monetary reserves. Indeed, continuing large payments deficits by the United States could create doubts about the stability of the dollar and threaten the efficient operation of the international payments system. As a result, the U.S. government has had to pay close and constant attention to the net financial outcome of its transactions, and those of its citizens, with the rest of the world. Important measures have been taken to improve the payments position of the United States, and domestic economic policy has been framed with attention to the balance of payments."

Here it will be recalled that the recovery from the 1960 recession in the United States was not particularly robust, with a disappointing slowdown in the pace of recovery in 1962. There was accordingly considerable pressure for domestic policy reasons to adopt expansionary fiscal and monetary policies. From an American perspective, the optimal way to resolve the balance of payments problem was, therefore, to deal with it

---

[17] For example, in the run-up to the Presidential election of 1960, fears that the new Administration would devalue caused the price of gold on the London gold market to spike to US$40 an ounce, compared to the Bretton Woods conversion price of US$35 an ounce. See Michael D. Bordo and Anna J. Schwarz, "Under What Circumstances, Past and Present, Have International Rescues of Countries in Financial Distress Been Successful," NBER Working Paper 6824, December 1998, p. 31.

directly: to expand the merchandise trade surplus further, to intervene in other current account areas such as travel, and also to directly address capital account issues such as foreign direct investment.

It is worthwhile in this connection to recall the international relations context of the era. The U.S. dollar's major role as a reserve currency to some extent held the world hostage to U.S. policy and forced acquiescence in U.S. policy decisions. As Barry Eichengreen describes:

> "They [the Kennedy and Johnson Administrations] acknowledged the severity of the dollar problem while displaying a willingness to address only the symptoms, not the causes. Dealing with the causes required reforming the international system in a way that diminished the dollar's reserve-currency role, something the United States was still unwilling to contemplate. Bolstering this otherwise untenable situation was international cooperation [such as] the London Gold Pool. .... America's ultimate threat was to play bull in the china shop: to disrupt the trade and monetary systems if foreign central banks failed to support the dollar and foreign governments failed to stimulate merchandise imports from the United States. Foreign governments supported the dollar because it was the linchpin of the Bretton Woods System and because there was no consensus on how that system might be reformed or replaced."[18]

A further point of significance in the context of this paper is that the request to Congress for negotiating authority in the Kennedy Round was based only in part on commercial considerations; geopolitical considerations also figured prominently as the request for sweeping negotiating authority

---

[18] See Barry Eichengreen, "Globalizing Capital: A History of the International Monetary System (Princeton: Princeton University Press, 1996), pp. 129-130.

was in part aimed at forging stronger ties with Europe and Latin America in particular.

It was in this broader context that President Kennedy sponsored the Trade Expansion Act of 1962, which authorized the Administration to negotiate tariff reductions of up to 50 percent and which provided the rationale for naming the round for President Kennedy

The new negotiations were agreed to at the meeting of ministers of the GATT Contracting Parties in Geneva in May 1963, but were formally launched only a year later; accordingly, negotiations ran from May 1964 to June 1967. The length of the negotiations reflected the fact that, for the first time, trade negotiations embraced issues beyond the tariff itself.

Throughout the Kennedy Round, balance of payments issues dominated the economic policy concerns of the successor Johnson Administration, as shown by the following contemporaneous developments:[19]

- enactment in September 1964, of the Interest Equalization Tax, which was designed to deter excessive U.S. purchases of foreign securities;
- in response to the worsening of the U.S. balance of payments in the fourth quarter of 1964, announcement by President Johnson of a 10-point balance of payments program of restrictive measures to stem the outward flow of U.S. dollars, including a Voluntary Cooperation Program, which requested U.S. businesses to restrain direct investments abroad in developed countries (February 1965);[20]

---

[19] See Foreign Relations Series Volume Summary, 1964-1968, Volume VIII, International Monetary and Trade Policy, Archive Site for State Department information prior to January 20, 2001. As Barry Eichengreen notes, "The array of devices to which the Kennedy and Johnson administrations resorted became positively embarrassing." See Barry Eichengreen, "Globalizing Capital", op. cit. p. 129.

[20] These included a ceiling on Canadian borrowings (which were exempt from the Interest Equalization Tax), the Gore Amendment, which applied the tax in respect of foreign debt obligations by commercial banks, a travel tax, and a cut in military expenditures abroad. Source: Foreign Relations Series

- consideration of mandatory restrictions on capital outflows (second half of 1965 and again in 1967);
- the expansion and tightening of the Voluntary Cooperation Program (December 1965 and increased pressure on businesses to participate in 1967);
- pressure on governments in countries where U.S. troops were stationed to make "offset" expenditures on U.S. military goods (first half of 1966; the United States had already successfully pressured Germany and Italy into agreeing to such offsets in 1962);
- consideration of still more drastic measures including a tax on tourist travel (second half of 1996);
- extension of the Interest Equalization Tax for two years (July 1967);
- enactment of the Foreign Investors Tax Act to attract foreign investors in U.S. securities (1967); and
- appointment of a public/private-sector task force to develop proposals aimed at expanding foreign travel to the United States (1967).

In short, during the run-up to, and the negotiation of, the Kennedy Round, the principal international economic policy issue confronting the United States and (as will be discussed below) many of the other developed countries was the balance of payments. The United States left few stones unturned in trying to stem the net outflow of dollars; it is difficult, therefore, to imagine that policy in respect of the single largest international activity involving the exchange of currency, namely merchandise trade, was anything but centrally motivated and guided by the same balance of payments concerns, including the ability to sustain convertibility of the U.S. dollar. If one wishes to understand the resurgence of interest in tariff policy in the mid-1960s after more than a decade of marginalization, one need look no further than the balance of payments pressures of that period.

Volume Summary, 1964-1968, Volume VIII, International Monetary and Trade Policy, Archive Site for State Department information prior to January 20, 2001.

In January 1962, during the course of the Dillon Round, the EEC agreed on the outlines of a Common Agricultural Policy (CAP). As discussed above, U.S. reaction to this development was at first ambivalent. The CAP was accommodated because of the contribution it made to European political unity, which the United States saw as desirable in the Cold War context. However, U.S. authorities were not oblivious to the risk that it could severely restrict U.S. market access in agricultural products in which it and other countries (including, *inter alia*, Canada, Australia and Argentina) were highly competitive. The Trade Expansion Act signed by President Kennedy in October 1962 was developed in part for the purpose of damage control: to limit the impact of the CAP on other agricultural exporters, including by reversing certain "early actions implementing the Common Agricultural Policy [that] indicate a trend toward increased protection."[21]

The early orientation of the CAP resulted in levels of support for agricultural exports being a prominent recurring theme throughout the Kennedy Round, even to the point of threatening its disruption. The course of negotiations and the International Wheat Agreement that emerged from the negotiations are further examples of how contextual economic policy developments (in this case the formation of the EEC and the catalytic role of the CAP within it) helped to shape the substantive outcomes of trade rounds as well as helping to determine their timing. By contrast, the internal logic of trade policy, as summarized by the Haberler Report, had been pointing to the need to address agriculture since 1958 without any noticeable effect on the course of actual negotiations.

A similar story can be told about the textiles component of the Kennedy Round negotiations. Here, it was a secular economic trend, namely the pressure on wool textiles from the emergence of synthetic fibres, which created domestic problems

[21] Economic Report of the President, January 1963, p. 114.

in textile production for the United States (and other developed countries). This resulted in the usual lobbying for restraints on imports. How these internal economic problems were handled, meanwhile, was quite importantly influenced by purely political considerations. In a letter to President Johnson in September 1964, U.S. Secretary of State Dean Rusk explained the textiles issue and then added this comment apropos of how it might be handled:

> "We are in real trouble in Japan as a result of the succession of restraints we have imposed on their trade over the past two or three years. We cannot afford again to make the same mistake with Japan that we made during the thirties. Italy also is, as you know, in a dangerous political phase—and actions by us to restrict their exports while their economy is so shaky would play into Communist hands. We know [Special Representative for Trade Negotiations] Chris Herter is also greatly concerned about this because of its implications for the Kennedy Round."[22]

Notably, the multilateral trade implications were an afterthought to the principal concerns of the Administration, which were geopolitical in nature. It is to be noted that this was an era of U.S. policy making in which the State Department still had responsibility for trade.

A third feature of the economic context in which the Kennedy Round unfolded was the interaction between trade and industrial policy measures that were encouraged (or at least not discouraged) by the general climate of concern about the balance of payments situation.

Perhaps the best example of this feature is the issue that became an important element of the Kennedy Round, namely

---

[22] Message from Secretary of State Rusk and the Under Secretary of State George Ball to President Johnson, in Texas, September 26, 1964, Foreign Relations of the United States, 1964-1968, Volume VIII, International Monetary and Trade Policy, Department of State.

the American Selling Price (ASP) valuation system for U.S. imports of benzenoid chemicals, which set *ad valorem* tariffs on the basis of the U.S. price rather than on the exporter's price. This constituted a non-tariff barrier, action on which the Europeans made a precondition for opening negotiations on chemicals. Another example was the Urban Mass Transportation Act, which imposed Buy American requirements on contractors paid with funds made available under that law.

Other Transitional Features

Several other features of the Kennedy Round are worth noting. First, reflecting the attempt made during this round to reach beyond tariffs, Congress declined to adopt the non-tariff measures agreed in the round (in particular, the Anti-dumping Code, the Chemicals Agreement and changes to the ASP valuation system). The trade policy tail had started to wag the economic dog, and Congress would have none of this. It will be recalled in this regard that Congress had ceded trade policy to the safer custody of the Executive Branch following the disastrous Smoot-Hawley Tariff Act of 1930,[23] but felt very possessive about domestic economic policy.

Second, the intrusions into domestic policy spheres also complicated the process of reaching agreement, underscoring the fact that the "club model" was starting to fray. State Department archives describe the scene in Washington during the days leading up to the May 15 agreement to conclude the Kennedy Round, which was signed in Geneva on June 30, 1967, as follows:

---

[23] The effective transfer of trade negotiating responsibility to the Executive Branch is associated closely with the person of Cordell Hull, Secretary of State in the Roosevelt Administration under whose tutelage the Reciprocal Trade Agreements Act of 1934 was developed. This Act was the precursor to the grants of "fast track" authority to postwar Administrations to engage in the GATT rounds.

"The sequence of events leading to a Kennedy Round agreement in May 1967 took on all the aspects of a foreign policy crisis, requiring Presidential decisions in Washington and round-the-clock meetings in Geneva. In order to manage last-minute Kennedy Round strategy, the President...in April 1967 ordered a small and secret command group at the White House, consisting of Under Secretary of State for Political Affairs Eugene V. Rostow, Under Secretary of Agriculture John Schnittker, Acting Secretary of Commerce Alexander Trowbridge, and [Deputy Special Assistant, Francis M.] Bator, to communicate directly in Geneva with [Special Representative for Trade Negotiations] William M. Roth."[24]

Third, the Johnson Administration took steps to "sell" the final outcome of the negotiations to interested segments of the American public. As the archival material suggests: "It was presumably with the need for public support in mind that in March 1964, President Johnson appointed 37 prominent citizens to a Public Advisory Committee on Trade Negotiations, ...and he considered advice from industry and labour leaders on such issues as anti-dumping."[25]

These developments foreshadow the complexities that now characterize the conduct of trade policy, such as the involvement of non-governmental organizations (NGOs) and the complex interplay of domestic policy interests with international obligations and objectives. In this context, the Kennedy Round may be said to have ushered in the modern era of trade liberalization. Alternatively, if one thinks of the early postwar period as "modern," then the Kennedy Round ushered in the post-modern era.[26]

---

[24] Foreign Relations Series Volume Summary, 1964-1968, op cit.

[25] Ibid.

[26] See William A. Dymond and Michael M. Hart, "Post-Modern Trade Policy: Reflections on the Challenges to Multilateral Trade Negotiations after Seattle," *Journal of World Trade* 34 (3): 21-38, 2000. Dymond and

The above story has played down the weight that the internal logic of trade policy had in shaping the actual outcomes. Accordingly, it should be noted that the trade policy community did not lose the opportunities for forward motion provided by the new-found momentum for trade liberalization. The Kennedy Round generated by far the largest gains in tariff reduction in the history of the GATT up to that time (they are even more impressive if one considers that the opening Geneva Round gains were in place *before* there was a GATT!). Moreover, despite the fact that the movement on agriculture was very modest, the round did deliver a significant achievement on the third of the Haberler Report's recommendations: a generalized tariff preference for developing countries was introduced into the framework of the multilateral system. (Even this, it should be noted, was driven by political economy considerations—it constituted a response to the formation of UNCTAD in 1964 and the formation of the Group of 77, a developing country bloc within the United Nations—rather than the internal logic of trade policy).[27]

The moral of the Kennedy Round story is that the trade policy community needs to "get when the getting is good." The chances to ratchet down trade barriers come rarely; it is only when the stars are aligned that significant progress can be made.

The Tokyo Round (1973-1979)

A review of the timing, the conduct and content of the Tokyo Round provides ample evidence of the growing importance of

---

Hart suggest that the Uruguay Round was the epochal event rather than the Kennedy Round as the above observations suggest.

[27] For a discussion of the evolution of the initial measures adopted by the GATT in 1965 into the familiar General System of Preferences, see Bernard M. Hoekman and Michel M. Kostecki, *The Political Economy of the World Trading System: From GATT to WTO* (Oxford: Oxford University Press, 1996), pp. 236-238.

contemporaneous economic and political developments in shaping events in the world of trade policy.

Prior to the round, extensive preparatory work had created what Michael Hart has described as "a solid intellectual foundation for negotiations reaching well beyond the traditional issue of lowering tariff barriers."[28] This included work done within the GATT work program itself, by the Rey Group in the OECD context, and in the United States by the Williams Commission, a blue ribbon panel appointed by President Nixon in 1970 (the report of this Commission is often described as providing the intellectual and public policy basis for U.S. leadership in the new round of GATT negotiations[29]).

However, the arguments for further liberalization were in the first instance entirely ignored—at least in the United States where the next major step taken by the Administration was the enactment in 1971 of the trade-restrictive Nixon Measures.

Moreover, whereas preparations for the round had centred on U.S.-European Community (EC) issues, including the important Article XXIV issues raised by EC expansion and agriculture,[30] the major outcomes and frictions of the Tokyo

---

[28] See Michael M. Hart, *50 Years of Canadian Tradecraft,* op, cit. p. 125.

[29] As it turned out, the United States did not, as had been customary, lead but rather followed others into the Tokyo Round. The negotiations were formally launched in the Tokyo Declaration of 1973. It was not until the end of 1974 that the Trade Expansion Act, which authorized U.S. participation in another round of GATT negotiations, was passed.

[30] Specifically, the preparations for the round within the GATT context had focused in good measure on the trade diversion that would be generated by the internal liberalization of trade within the EC and by the entry of new members, who then also became associated with the European aid and trade agreements with developing countries (the Lomé Convention). Michael Hart describes the preparations as follows: "Preparations for the round had made it clear that it would be dominated by the United States and the EC, with Japan still not ready to become an equal partner.... the Tokyo Round would be a bilateral negotiation masquerading as a multilateral negotiation." See Michael M. Hart, *50 Years of Canadian Tradecraft,* op, cit. p. 126. The 1973 Economic Report of the President provides a tidy summary of the issues from the perspective of the United States.

Round centred on non-tariff barriers and safeguards—issues that had much more to do with U.S.-Japan trade than U.S.-EC concerns.

To understand what did come out of the Tokyo Round and to understand the actual course of events (including the lengthy delay before serious engagement on the issues actually was made in the late 1970s), it is necessary to return to the broader economic context and specifically to focus on (a) the factors that led to the Nixon Measures of 1971; and (b) the emergence of Japan as a major economic actor on the international scene.

The Nixon Measures

The early 1970s witnessed one of the epochal events of postwar economic history: the breakdown of the Bretton Woods system of fixed exchange rates. This happened in stages.

Very briefly, as noted earlier, the Bretton Woods era witnessed persistent U.S. balance of payments deficits. These led to a growing glut of U.S. dollars abroad, which in turn generated pressure on the U.S. dollar. This led to a series of responses, including the formation of the London Gold Pool in 1961, which essentially institutionalized the arrangements between the Federal Reserve and the Bank of England to fight off the run on the dollar in October 1960. Under the London Gold Pool, the Bundesbank and several other Western European banks joined the Fed and the Bank of England in stabilizing the price of gold on the London gold exchange below US$35.20.

Things began to unravel in 1967: in June, France withdrew from the Gold Pool and in November, balance of payments deficits forced the United Kingdom to devalue sterling, triggering another run to gold. In March 1968, the gold market was closed for two weeks, the London Gold Pool was disbanded and the so-called "two-tier system" was set up with convertibility limited to central banks.

This settled things briefly: after spiking into the $40 range, the price of gold returned to about $35. However, the expansionary fiscal and monetary stance adopted in the United States in 1971 following the 1970 recession (and widely

interpreted as a way to ensure President Nixon's re-election in the 1972 campaign) plunged the United States into its first trade deficit of the postwar period (and, indeed, its first since 1888), exacerbating the balance of payments deficit and driving U.S. gold reserves to a record low.

In rapid succession, the Bundesbank announced the floating of the Deutsche mark in response to speculative inflows (May 1971), the Bank of England prepared a request for a US$3 billion dollar conversion (August 9, 1971), and the Nixon Administration responded with the aforementioned Nixon Measures announced August 15, 1971: a "temporary suspension" of convertibility of dollars into gold, a 10 percent surcharge on imports, a 90-day freeze on prices and wages, and a tax on overseas capital investment.

Several months later, in December 1971, the Smithsonian Agreement re-established the Bretton Woods system. The price of gold was increased from $35 to $38 per ounce. This devalued the dollar by 8.5 percent, while other currencies revalued (the biggest revaluations were effected by the yen, which rose 17 percent against the dollar, and by the Deutschemark, which increased by 14 percent). However, despite expanded fluctuation bands, the parities agreed to under the Smithsonian Agreement could not be sustained and by early 1973 the major currencies were all floating.

In September 1973, in Tokyo, with the United States lacking negotiating authority as noted above, the new round was launched.

Arguably, it was the collapse of the Bretton Woods system and the overt protectionism of the Nixon Measures that galvanized the international community and elicited uncharacteristic leadership from Japan, the GATT member that appears to have felt most threatened by the new developments,[31] and that fortuitously happened to be the host of the Ministerial Conference that launched the round.

---

[31] The United States had only recently targeted Japan with voluntary export restraints on textiles, and also for the first time on steel.

The Hiatus in Negotiations

A remarkable feature of the Tokyo Round is that negotiations went almost nowhere for the first four years or so. There is no real explanation for this from the internal logic of trade policy. A well-prepared intellectual basis for the round was in hand. The first meeting of the Trade Negotiations Committee (TNC) had taken place in late 1973. The U.S. negotiating authority, albeit delayed, provided adequate authority for a major outcome. This was in hand by early 1975, by which time the delegations were also well established in Geneva. Yet serious negotiations were not engaged until early 1977. As Michael Hart observes, "the outward appearance was that the negotiations were marking time".[32]

One explanation is that there was too much else going on in the world—the Yom Kippur War and the ensuing first oil crisis, Watergate and the impeachment of President Nixon, and the U.S. presidential elections in 1976. However, the world is a busy place at any time. Consideration of the economic context provides a more compelling reason for the four-year hiatus.[33]

In the aftermath of the collapse of the Smithsonian system, the European countries elected to maintain the Smithsonian fluctuation bands among each other while the United States and Japan elected to float.[34] For the floaters, the balance of

---

[32] See Michael Hart's description of the early phase of negotiations. See Michael M. Hart, *50 Years of Canadian Tradecraft*, op, cit. at pp. 131-136.

[33] In this regard, it will be noted that the troubled politics of the day did not distract work on the major international economic policy issues of the day: the recycling of petrodollars, the emergence of the Eurodollar market, and the ongoing work to develop a new international financial structure that would culminate in the Second Amendment to the Articles of Agreement of the IMF, which in effect legalized floating. This weakens the case for a lack of attention being the reason that the negotiations marked time for so long.

[34] The European decision reflects the fact that they had large trade shares of GDP and were constrained by the functioning of the EEC, including the CAP. The United States and Japan, by contrast, were both large economies with fairly small trade shares of GDP. For them, floating made more sense.

payments ceased to be a policy "problem" *per se* as the exchange rate became the mechanism of adjustment.

The yen appreciated from its Smithsonian parity of 308 to the 260-265 range, and for 1973 as a whole, averaged 271 to the dollar, an appreciation of about 33 percent from the pre-1971 Bretton Woods parity of 360. This more or less offset the depreciation that the yen had effected in real terms during the Bretton Woods era.[35]

The exchange rate realignment, coupled with the oil price hike, resulted in Japan's current account surplus being wiped out, Germany's being sharply reduced, and the United States deficit being transformed into a surplus of US$18 billion in 1975, which was massive for the times. In short, for the United States, the external economic issues had been addressed and there was no immediate need to press forward at Geneva. And so the trade negotiators "marked time."

The Re-emergence of Pressures and the Gain in Momentum

Forward movement on the Tokyo Round was not restored until 1977. Importantly for this analysis, this coincided with the re-emergence of external pressures for the United States: as the U.S. economy recovered from the 1975 slump, its current account swung sharply back into deficit. In 1977, the deficit was almost as large its surplus had been in 1975.

For the new Carter Administration, which took office at the beginning of 1977, the external situation posed a severe constraint on its policies seeking to invigorate growth. Not surprisingly, U.S. attention focussed particularly on Japan, which had in the meantime swung back into a large surplus, aided by the fact that the yen had in the meantime depreciated back to the 300 range. Under pressure from the Carter

[35] One estimate put the Bretton Woods era real appreciation of the yen at 27 percent. For a discussion, see C. R. Henning, *Currencies and Politics in the United States, Germany and Japan*, Washington, Institute for International Economics, 1994), pp. 123-127.

Administration, the yen soared.[36] For 1978 as a whole, it averaged 210 per dollar, 71 percent above its Bretton Woods parity, at one point breaking through the 200 mark.[37] Pressure was also brought to bear on Japan's through the G7 to adopt expansionary fiscal and monetary policies. The results were manifest in that Japan pushed interest rates to record lows and expanded its fiscal deficit to a high of 5.5 percent of GDP in 1978.

Accordingly, the resumption of movement in the round coincided with the re-emergence of external pressures on the United States and important developments in the international finance arena, most importantly the second major episode of yen revaluation.

The Results of the Tokyo Round

While the Tokyo Round resulted in broad tariff reductions, it is more noted for several supplementary agreements, namely the codes on dumping, government procurement, standards, and subsidies, as well as strengthened procedures that substantially expanded GATT's role in resolving trade disputes.

The nature of this outcome, involving a heavy admixture of beyond-the-border issues to the tariff exercise, come as no surprise in light of the U.S.-Japanese trade conflicts of this period—the United States countered what it saw as protectionism with its own protectionism and with an attempt to reach inside the Japanese border to counter the frustrating non-

---

[36] The Deutschemark also came under upward pressure but to a much lesser extent.

[37] For an account of this period from a capital market perspective, see Barry Eichengreen, "Globalizing Capital," op cit. pp. 141-145. Also see C. R. Henning, *Currencies and Politics in the United States, Germany and Japan*, Washington, Institute for International Economics, 1994, pp. 127-129. Henning describes the dispute between the United States and Japan as acrimonious, with the United States accusing Japan of maintaining an inappropriately competitive exchange rate and disguising the true extent of their interventions by using private banks.

tariff measures that Japan, in the eyes of the United States, was using to run up its structural surpluses.

Even the unfinished business centred on U.S.-Japan issues: the Japan-U.S. bilateral tariff negotiation and the "safeguards" negotiation, which centred on market disruption by low-cost imports from the developing countries. Addressing safeguards had been an important element of the Tokyo Declaration, and clearly represented an important issue for Japan, which felt targeted by the use of such measures, by the United States in particular.

Generally, the waxing and waning of momentum in the Tokyo Round matched the waxing and waning of revaluation pressures on the yen. None of this is obvious from a uniquely trade policy-centric interpretation of the unfolding of the Tokyo Round; the broader context counted.

The Uruguay Round (1986-1994)

The connection between the Tokyo and Uruguay Rounds is evident in a number of ways, including the fact that the latter was much concerned with the unfinished business of the former. Substantively:

- trade in agriculture and the growing area of services trade were still conducted outside the framework of the GATT;
- textiles trade was dealt with in the GATT but in contradiction to its principles;
- a variety of new restraints on trade (e.g., the so-called "grey-area" measures such as voluntary export restraints or VERs) flourished in the early 1980s; and
- the various new codes negotiated in the Tokyo Round had revealed their flaws when put into practice.

There was, accordingly, a ready-made and well-understood trade agenda to be dealt with. From a trade policy perspective, the launch of the Uruguay Round was thus to be a return to trade business as usual in refining and perfecting the rules-based system. The only thing required was for the United States to exercise its customary leadership.

What accounts, then, for the failed GATT meetings following the completion of the Tokyo Round, including at the Ministerial level (e.g., in 1982)? In addressing this question, it is useful to again return to contextual factors.

Another Hiatus from Pressures on the Trading System

While the Tokyo Round may have left unfinished business for trade experts to address, the yen (and mark) revaluations of the late 1970s, coupled with the second oil price hike, again caused the external accounts to swing: Japan and Germany fell into deficits while the United States moved into surpluses.

With no real fish to fry on the external side, and with serious domestic issues facing it, the first Reagan Administration, which took office at the beginning of 1981, turned to matters at home. With Paul Volcker at the helm of the Federal Reserve, all stops were pulled out in halting and reversing the acceleration in inflation that had marked the 1970s. Meanwhile, the supply-side revolution was launched to reinvigorate the U.S. economy.

It was in this context that the 1982 GATT Ministerial meeting failed to achieve the launch of a new round of trade negotiations that trade policy practitioners had been working towards.

Things however were soon to change in this regard as the domestically focused U.S. policies began to result in large external imbalances. The restrictive monetary stance of the Fed under Volcker caused the U.S. dollar to appreciate. At the same time, the combination of tax cuts and fiscal stimulus resulted in the emergence of large fiscal deficits. These factors contributed to a steep deterioration of the current account. From a surplus in 1981, the current account balance slid to deficits of US$12 billion in 1982, US$44 billion in 1983, and US$99 billion in 1984.

By the second half of the first Reagan Administration, external pressures were being felt politically as exporters and import-competing industries began to complain. Japan came under pressure to strengthen the yen. However, it was not until the second Reagan Administration with James Baker, described

by Barry Eichengreen as "pragmatic and interventionist," in the U.S. Treasury that a full-fledged policy shift in the United States took place.[38] The main economic problems in the United States were now seen to lie in the over-valued dollar and the trade protectionism of its partners, in particular of Japan, which was again building up large surpluses. The post-Tokyo Round hiatus for trade policy would soon be over.

The Establishment of Launch Conditions and the Role of Japan

The renewed interest of the United States in its external position found Japan (and to a lesser extent Germany) in a vulnerable position. Even as the U.S. current account deficit climbed to US$124 in 1985, Japan's surplus rose to US$51 billion. Germany also had seen its surplus increase, albeit to a much more modest level of US$18 billion.

The first major action taken to address this was the Plaza Accord of December 1985, which signalled the desire for a substantially lower valuation for the dollar, and a significant appreciation of the yen and the European currencies. Japan also came under pressure again from the United States and other G7 partners to adopt more expansionary monetary and fiscal policies.

However, rather than improving, the external imbalances widened in 1986. The U.S. deficit sank to a new record of almost US$150 billion while Japan's surplus soared to US$86 billion and Germany's to US$41 billion. The focus shifted to trade and the road led to Punta del Este, Uruguay, where on September 15, 1986, yet another GATT Ministerial convened and a round of trade negotiations, the eighth, was launched.

The United States is generally credited with taking the lead in launching the Uruguay Round. Indeed, the EC and Japan are typically described as cautious about the proposed negotiating agenda, while some developing countries, notably India and

---

[38] See Barry Eichengreen, *Globalizing Capital*, op. cit. p. 149.

Brazil, were openly critical. Seen in context, the United States can be said to actually have steamrolled the opposition in order to get an agreement.

The Course of Negotiations

The chequered history of the Uruguay Round negotiations also deserves comment from a contextual point of view. Certainly, the low point in the process came with the failure of the 1990 GATT Ministerial in Brussels, which cast considerable gloom over the eventual prospects for the round. Several developments intervened between the launch of the round in 1986 and this, the nadir of the process.

First, U.S. attention shifted to regional trade pacts, first with Israel but then much more importantly with its largest trading partner, Canada. The Structural Impediments Initiative (SII) was launched in 1989 to directly target Japan's surpluses. The post-Plaza dollar devaluation eventually yielded dividends, as the weakening of the dollar (including against the Canadian dollar) reversed the trend on the U.S. current account. This was aided and abetted by the slowing of the U.S. economy and fiscal contraction. By 1990, the U.S. current account deficit had been cut in half compared to its peak level of US$163 billion in 1987 and was on its way to a surplus of US$4 billion in 1991. In short, the United States was achieving success through means other than the multilateral negotiations. With the pressures on the United States dissipating, if not entirely defused, pressure on the trade negotiators eased. While it would be a stretch to draw a cause and effect relationship between any of these developments and the failure to conclude the round on time, it is noteworthy that the context was not exactly propitious for success.

The actual conclusion of the round several years later also seems to have been helped by some fortuitous circumstances.

First, in the United States, economic recovery coincided with a steep widening of the current account deficit (which reached US$134 billion in 1994 when the Agreement at Marrakech was signed). At the same time, a currency solution to the U.S.

external deficit was simply not to be had, as the dollar was already plumbing its all-time lows against the yen and mark while the rise of the latter two currencies was acting as a tourniquet on growth in Japan and continental Europe respectively. Accordingly, trade policy was the best available tool and the United States put its weight behind it. In rapid succession, the Uruguay Round was concluded, the NAFTA agreement was signed and in Bogor, Indonesia, the APEC commitment to free and open trade in the Asia Pacific was announced—all took place in 1994.

Second, in the developing world, the explosion of export-led growth in East Asia changed attitudes. Whereas many developing countries had signed onto a new round at Punta del Este in 1986 because they had been effectively pressured into doing so, now they were actually beginning to embrace the concept of trade liberalization as a growth strategy *par excellence*.

Europe, meanwhile, had already spent much of its powder in terms of stimulating economic growth through the single market exercise that was completed in 1992. It was still experiencing slow growth, not least due to the high valuation of European economies linked to the upwardly mobile mark, the diversion of Germany's energies to dealing with reunification, and the fiscal restraint imposed by the need of many member countries to meet the Maastricht conditions for monetary union. Accordingly, it needed a deal to help reinvigorate economic growth as well.

Japan, meanwhile, remained under intense pressure, as its current account surplus reached its ultimate zenith in 1993-1994 at US$131 billion and US$130 billion respectively, while the yen was nearing its ultimate peak of 79 to the dollar, which would be reached in April 1995.

Simply put, a trade deal was much easier to pull together in 1994 than it had been in 1990. Circumstances and context mattered very much.

Seattle

The causes of the failure of the WTO Ministerial at Seattle in November/December 1999 have generally been discussed in trade policy terms, with particular emphasis on the role of civil society. The context has not been entirely ignored given the hard-to-miss influence of the U.S. political calendar on the management of the Ministerial by the Clinton Administration—most notably, the speech given by President Clinton on the eve of the Ministerial, which focused on the inclusion of labour rights in any round, an allusion with political importance in the upcoming presidential campaign but a poison pill for the negotiations.

Other elements of the contextual setting for the launch of a new round in Seattle, however, have tended to be given short shrift, if weighed in the balance at all.

From the perspective of the arguments made above, the United States in 1999 was not in a situation that would make it a strong supporter, and certainly not a leader, of new negotiations. While it had a large current account deficit, indeed an unprecedented one in historical perspective, it was also approaching the negotiations from a position of almost unprecedented economic strength in all other regards. U.S. confidence was at an all-time high due to the wealth created by the dot.com phenomenon that rode as well as drove the technology and equity market boom of the late 1990s. Any insecurities that the United States might have had about the rising stars in East Asia were now a forgotten nightmare—the Asian crisis had exposed Japan and the other "tigers" as mortal, and indeed, Asian economics had been widely dismissed as representing an inferior and corrupt economic model.[39] The domestic issues now centred on the relatively pleasant decision

[39] Recall here the credit that Paul Krugman was widely given for purportedly anticipating East Asia's demise in his article, The Myth of Asia's Miracle, which compared the East Asian growth model to that of the Soviet Union in terms of being based on the mobilization of latent factors of production rather than innovation and efficiency gains.

of how to spend what seemed like almost unimaginable fiscal surpluses. Meanwhile, the United States was no longer viewing events such as Sony buying CBS as evidence of U.S. decline, but rather as evidence of its global leadership—foreign capital was converging on safe American shores. And the U.S. dollar, although still comparatively low vis-à-vis the yen and mark by historical standards, was riding high in North America and generally faring well on the world's currency markets.

The only economic issue of concern was the current account deficit, and even this was not an immediate issue. First, it was being discounted because of the positive role that it was playing in supporting the economic recovery in Asia from the 1997-1998 economic and financial crisis. Moreover, the pressures were not immediate because of the influx of investment capital. Writing before Seattle, Catherine Mann, a well-respected U.S. trade economist, concluded that the U.S. current account deficit would be sustainable for several more years.[40] In politics, that is close to eternity.

At the same time, insofar as there *was* a political aspect to the current account issue, it was with respect to China's bilateral surplus with the United States. The collapse of Japan's "geoeconomic" challenge, coupled with the spectacular rise of the Chinese economy, had put the latter economy on the U.S. radar screen, much the way that Japan had loomed in the run-up to the Tokyo Round.[41] But China was not in the WTO, and U.S.

---

[40] See Catherine L. Mann, *Is the U.S. Trade Deficit Sustainable?*, Washington, D.C.: Institute for International Economics, 1999.

[41] By the 1980s, Japan had not only shown up on the U.S. radar screen, it was seriously posing its "geoeconomic" challenge to the United States. Like the Soviet Union in the early 1960s, Japan worked differently than the United States and, like the Soviet Union, it was putting up challenging growth rates and recording technological successes. In short, Japan had announced itself as a force to be reckoned with—and in a more fundamental sense than simply trade in textiles or autos. Japanese concepts such as *keiretsu* were appearing in U.S. business discussions—in contrast, one might add, to critical commentary on Europe, which was suffering from "eurosclerosis" in the view of many analysts. By the late 1990s, however, concern about Japan had been replaced by a certain triumphalism.

bilateral issues with China were being addressed in the latter's accession negotiations. The contribution that a round could make to this was not at all clear.

In short, there was a singularly poor alignment of contextual factors prior to Seattle, quite apart from the travails of WTO members themselves in setting an acceptable and feasible agenda, the poor organization and chairmanship of the conference, the clash of cultures, and the clash of interests on the substantive aspects.

Doha and beyond

Given the above analysis, little needs to be said about the new round just launched November 9-14, 2001 at Doha. The dramatic change in context is clear.

Shortly after Seattle, the U.S. economy ran into severe head winds. The economy slowed down, the bursting of the dot.com bubble and the emergence of severe over-capacity in several technology sectors, including computer chips and fibre optics, triggered an equity market downturn and a sharp decline in business and consumer confidence.

The external pressures on the United States continued to be large with the current account deficit declining only marginally during the recession year of 2001 (to US$417.4 billion, down from US$444.7 billion in 2000), in contrast to previous recession years when the United States external balances swung into surplus (including in 1975, in 1980-81 and in 1991). The expected economic recovery over the course of 2002 and beyond would not tend to ease these pressures.

At the same time, the continued rise of the U.S. dollar has left it highly valued in comparison to most global currencies although not necessarily vis-à-vis the two major ones—the yen and euro. This poses difficulties for a monetary fix to the external balances of the G3: to correct the massive U.S. current account deficit would require a substantially lower valuation for

Meanwhile, China had taken Japan's place as the object of American geopolitical (if not yet geoeconomic) concern.

the dollar, but with Japan mired in recession and Europe's economy grinding to a standstill, sharply higher valuations for the yen and euro would work to choke growth in those quarters. In fact, the situation in late 2001 was not unlike the early 1990s when there also was no easy currency fix to the set of external imbalances within the G3.

A domestic solution to the U.S. external imbalance (i.e., a sharp increase in domestic savings) also seemed not to be imminent. The United States was expected to go into deficit on the fiscal accounts in 2002 and for at least several years into the future. For its part, the household sector was helping to carry the economy by converting housing equity into debt. This would leave it to the corporate sector with weak short-term earnings prospects to become a net saver to restore balance to the external accounts. There is no precedent for such a configuration of savings-investment relationships.

Accordingly, as the Doha meetings approached, trade offered a more promising route to resolving problems on the external accounts—difficult as this might be to achieve in a multilateral trade agreement that involves give and take.

By itself, however, the changed economic situation in the United States may not have been sufficient to create launch conditions. For many months, as the preparations for Doha progressed, the key contextual elements from Seattle remained largely in place. Most importantly, the United States and the European Union remained divided concerning the scope of a new round. For their part, the developing countries remained sceptical about the benefits that they had achieved in previous deals, as well as about what they stood to gain in any round of expanded negotiations. Also, the violence surrounding street opposition to further trade liberalization escalated progressively from the Quebec City Summit of the Americas (May 2001), to the U.S.-EU Summit in Göteborg (June 1971), and the G7/8 Summit in Genoa (July 1971), where the first fatality of what might be termed the "trade intifada" was recorded.

From a trade policy perspective, why Doha should succeed where Seattle had failed was therefore not especially evident during the preparatory phase. Indeed, it is fair to say that

expectations were shifting toward the accession of China and Taiwan being the biggest gain for the global trading system from the Doha meeting.

The rather bleak prospects for the launch of a new round of trade negotiations received, however, a boost from an unexpected source: the September 11 attacks on the World Trade Center and the Pentagon.

At least in the short term, the attacks raised the cost of doing international business[42] at a time when trade was already slumping sharply due to a synchronized economic slowdown in the major industrialized economies.[43] Moreover, the attack on the World Trade Center (if not the attack on the Pentagon and the unknown other target) represented to some extent an attack on globalization itself. In this context, a newfound sense of urgency concerning the Doha outcome thus emerged—a launch was needed if only to send to consumers and markets a signal of confidence in the globalized economy and to dispel the shadow of Seattle.[44] Success at Doha was, thus, in many ways the product of the political imperative to have a success.

---

[42] Work by the Organization for Economic Cooperation and Development (OECD) Trade Committee and others indicates that the increase in frictional costs of trade was largely offset by the ensuing decline in the price of oil, which cut transportation costs. However, there was a palpable increase in time (and variability) of goods and businesspersons to transit borders, as well as a severe short-term contraction of the airline and tourism industries. One of the many reasons for reduced passenger volumes in the weeks following the attacks was a straightforward quantity response to an increase in the real price of travel, taking into account not just the financial costs but also the time costs. This had negative implications for trade, since less travel probably equates, at least in the short term, with less business. Moreover, higher border transit costs increased the effective protection from import competition for domestic production. For the most part, the negative impacts appear to be transitory; markets have shown much resilience.

[43] The growth of trade was projected to slow to only 2 percent in 2001 from 12 percent in 2000. See the *WTO Annual Report*, 2001.

[44] For example, Guy de Jonquières writing just prior to the WTO ministerial meeting reported that "The economic damage inflicted by the September 11 attacks in the U.S. has galvanized efforts to launch a global

What, then, might be said about the foreseeable future in terms of the conditions for negotiating success of the multilateral trade negotiations now under way?

First, given the circumstances surrounding its launch, and in particular the role of geopolitics in providing the decisive impetus, the Doha Round resembles most closely the Dillon Round. Given the modest trade policy success recorded in that round, this is not propitious in the narrow trade policy sense.

From this perspective, the new round can therefore be expected to be one of the most difficult ever, with only modest negotiating success at the end.

Summary and Conclusions

The postwar era was a period in which the lessons of the destructiveness of the wave of protectionism in the interwar period remained vivid. A series of multilateral rounds of liberalization of trade and international payments were launched in rapid succession in the late 1940s and through the 1950s. Pressures for protectionism were, in the normal course, mostly ignored (with some notable exceptions, as in the case of agriculture).

By the late 1950s, success was being declared by many: the international trade and payments system was back to functioning soundly. Trade policy experts set out and discussed, largely among themselves, the major issues that still needed to be addressed. However, forward movement on these would be had only when economic pressures and geopolitical or geoeconomic reasons dictated.

---

trade round—so much so, that many diplomats now think a deal can be done in Doha." See "Dealing in Doha," *Financial Times*, November 6, 2001, p. 14. See also, "WTO seen pressured to launch talks," *The Globe and Mail*, November 1, 2001, p. B7. Speaking before the Council on Foreign Relations on October 30, 2001, USTR Robert Zoellick emphasized the linkage: "The events of September 11 have set the stage for our work, just as officials meeting in Geneva 54 years ago needed to consider the imperatives of their time."

Toward the end of the Bretton Woods era, balance of payments pressures on the United States resulted in a slew of policy actions aimed at stemming an outflow of reserves. Some of these were trade restrictive, setting a pattern for the coming decades. At the same time, the external pressures provided the impetus to move forward on trade.

After the breakdown of the Bretton Woods system in the early 1970s, the focal point for financial pressures shifted from the balance of payments to exchange rate alignments. As has been recounted above, trade and finance did not always, or even often, work hand-in-hand to create a seamless globalized market, but rather, disjuncture in one repeatedly created intolerable pressures in the other. The waxing of financial pressures worked to prompt the launching or closure of trade rounds; the waning of financial pressures led to frequent hiatus in negotiations, or to the protraction of existing negotiations.

This discussion raises interesting questions about the observed need for round after round of trade liberalization. Trade practitioners argue on the basis of the "bicycle theory": constant liberalization is required if the international community is not to see erosion of past gains in liberalization. The essence of this analogy has been captured in economic theoretic terms by Hoekman and Kostecki, who observe that, given the presence of rent-seekers, governments not being committed to *laissez-faire* and imperfect markets, one country can gain welfare at the expense of others by imposing negative externalities on them. The market solution to this is based, as they demonstrate, on the Coase Theorem, which holds that, given enforceable property rights and in the absence of transaction costs, such externalities will be bargained away to yield a Pareto-optimal outcome. In other words, the emergence of an institutional framework for trade negotiations is a market response to imperfections in the global economy that allow the imposition of negative externalities by some countries on others.[45] There is no state of rest or equilibrium in this system as

[45] For a discussion see Hoekman and Kostecki, op. cit., Chapter 3.

long as new sources of externalities or new opportunities to exploit old externalities present themselves to economic agents. This means that the focus of negotiations must also shift.

Interpreting the historical review in light of this theory, the process of trade liberalization in the postwar era is seen to have been propelled by the same factor that repeatedly generated financial crises in the postwar era: the perpetual frictions between trade and the broader financial context, which provided both the opportunity and the pressures for countries under pressure in one area or another to impose externalities on others. The shift from the "traditional" agenda of tariffs to the "new" agenda of inside-the-border measures is thus simply a reflection that the means of exploiting externalities had shifted from the tariff to other measures.

One way or the other, the understanding of the process of trade liberalization of the postwar era as principled trade policy driving efficiency-generating domestic economic adjustment, while perfecting an international rules-based system, cannot be seen as the whole story: broader economic issues of the day weighed heavily in determining outcomes, at least from the 1950s onward.

The Nuanced Case for the Doha Round*

John M. Curtis and Dan Ciuriak

Introduction

In the stocktaking that followed the failure of the Third Ministerial Meeting of the World Trade Organization (WTO) in Seattle in December 1999, the strength of the case for a new multilateral round of trade negotiations was questioned.[1] Certainly, the preparedness of both developed and developing countries to walk away from the Seattle meetings without an agreement did not suggest conviction that benefits too big to pass up had been left behind on the negotiating table.

While the hurdles that had proved to be insurmountable at Seattle were overcome at Doha, where a new round of multilateral trade negotiations was launched, the main reason for success had less to do with the positive case for trade than the political imperative of dealing with a series of adverse events.[2]

---

* The views expressed in this paper are those of the authors and are not to be attributed to the Department of Foreign Affairs and International Trade or the Government of Canada. The research assistance and comments of Shenjie Chen and Konstantin Loukine in compiling the empirical analysis of the gains of trade from a new round is gratefully acknowledged.

[1] For a discussion, see Dan Ciuriak, "The Case for a New Round: Has It Been Made?" in *Trade Policy Research 2001* (Ottawa: Department of Foreign Affairs and International Trade, May 2001).

[2] For a discussion of how the agreement at Doha was forged see the opening chapter in this volume, Daniel Drache and Sylvia Ostry, "From Doha to Kannanaskis: The Future of the World Trading System and the Crisis of Governance", pp. 1-31. For a discussion of the changes in the economic context that worked to facilitate a launch at Doha, see John M. Curtis, "The Role of Contextual Factors in the Launching of Trade Rounds", pp. 32-69.

Agreement to launch a round is only the first hurdle to further trade liberalization. In the coming months and years, as the negotiations and work programs advance, the major hurdle will become creating a political consensus on the need for a successful conclusion to enable the tradeoffs that are usually necessary to structure a deal. The development of a powerful and compelling case for a deal will become a major priority for the trade policy community.

What can be said at this time about the gains from further, comprehensive liberalization? What, in effect, is the substantive case for the Doha Round?

Updating the context for liberalization

The progressive liberalization and accompanying expansion of trade and investment in the second half of the 20th century has fundamentally altered the context for trade policy. Accordingly, it will be helpful to consider where the starting line is with respect to the new round.

The starting point is a comparatively open trading system

First, as a result of eight multilateral rounds and the still deeper liberalization within the major economic zones through regional trade agreements, it can be safely declared that the destructive disruption of trade and other international economic activity by two world wars and the erection of trade barriers in the 1930s has been reversed. Trade growth has substantially exceeded growth in economic activity for decades. The degree of openness of the global economy is again approximating that which was reached at the previous height of globalization in the period prior to WW1.

Second, the understanding that trade is a vital part of a modern economy has taken firm root: the idea of self-sufficiency is not even used as a straw man any more. Thus, while protectionist pressures routinely emerge, accommodation thereof is the exception rather than the rule. The large majority of UN member states are now WTO members and about 30

applicants wait in line. Moreover, many nations are members of even deeper regional free trade arrangements, with the result that the majority of cross-border trade is conducted under conditions of more or less free trade. In short, trade is accepted as an essential part of economic development to an unprecedented extent.

Third, a rules-based trading system has been created, progressively strengthened, and is not only up and running but arguably running quite well. The volume of trade that is subject to disputes is minuscule compared to the volume that isn't.

The case to be made today, therefore, is not so much the case for trade or for a rules-based system *per se*, as for improving at the margin a system with which we have had a certain amount of experience and which is working tolerably well, and for making an already quite open global economy a bit more open.

The political economy of liberalization has changed as the degree of openness has increased

The increase in the degree of openness of the industrialized world, of the emerging markets, and of many developing countries has changed the political economy of further liberalization quite fundamentally.

In the first instance, in the process of getting to the present state of openness, the potential gains from trade, as identified in trade theory, have to a significant extent probably been realized.[3] For the more liberalized economies, the inevitable point of eventually diminishing returns to openness may well

[3] This most likely even includes the potential gains from trade in sectors that have not yet been liberalized. For example, trade theory suggests that the structural adjustment in liberalized sectors can result in a structural adjustment in non-liberalized sectors. In highly open economies, where most sectors are already open, the potential gains from trade from liberalizing the remaining closed sector may therefore have already have been extracted. For a discussion of this issue in the context of services trade, see Brian R. Copeland, "Benefits and costs of trade and investment liberalization in services: Implications from trade theory," in the present volume.

have been reached, meaning the benefit-cost ratio is lower than at the start of previous rounds.[4]

Second, since liberalization arguably proceeded fastest where trade-related issues were least significant, the remaining areas subject to liberalization are likely to pose the most challenging side issues.

In this regard, it is important to remember that, in the postwar period, liberalization affected, for the most part, industrial commodities produced by urbanized workers with narrow industrial skills that could be acquired in comparatively short intensive training. "Structural adjustment" meant a change of jobs but not necessarily a change of home or community. The impact on families was mostly incremental. The main pain was concentrated in smaller isolated communities, particularly those associated with primary resources where alternative employment and income sources were hard to come by.

By contrast, liberalization in the near and medium term deals with agriculture, which remains primarily a family farm business worldwide. The farmer's skill set is wide, and farming is an art as much as a science. It cannot be easily taught, and generational replacement is an issue. The setting is rural with limited off-farm employment opportunities: in this context, structural adjustment uproots families. The social consequences are narrower but much deeper, particularly inter-generationally.

Equally importantly, the subject matter of agriculture is biology not mechanics. Biological organisms and ecosystems are much less well-understood than are machines, and the consequences of change that impacts on these areas are not foreseeable. Typically, the wealthier a society becomes, the more it values safety and the less concerned it is about the price of food.[5] Simply put, the trade-offs between market and non-

---

[4] For a discussion of this possibility, see John F. Helliwell, *Globalization: Myths, Fact and Consequences*, Benefactors Lecture, 2000, C.D. Howe Institute, October 2000.

[5] An increase in the price of rice causes riots in Asian developing countries but we have not seen Europeans, U.S citizens or Canadians going en masse into the streets about higher food prices (nor are we likely to if the

market considerations in agriculture appear to be different than in other areas.

In the second major area of the new agenda, trade in services, there is a plethora of trade-related issues that have only limited commonality with one another let alone with goods trade issues, which considerably complicates the development of accepted regulatory norms for openness. In merchandise trade, moving from children's toys to cars or steel rod raises new regulatory issues. However, the distance one moves conceptually is less than moving from health to financial services or to what we Canadians and a number of our friends call the cultural industries. A service often cannot be separated easily from the person delivering it; dealing with regulation of people and of the processes involved in delivering the services is a lot more complex than dealing with regulation of goods. Perhaps most importantly, political economy choices by many countries have kept market economics out of many areas of social services. Liberalization in these cases is not an instance of opening up markets where they exist, but creating markets where they do not exist, a radically different proposition.[6]

Third, most liberalization in the past occurred between advanced, industrialized countries with reasonably well-developed political and social frameworks to deal, however imperfectly, with the questions of who gains from trade within a country, who loses, and how to handle compensation, adjustment and transition. Now liberalization is being widely embraced within the group of developing countries, many of which lack these frameworks.

Moreover, aggressive liberalization by developing countries hoping to achieve economic miracles à la East Asia involves telescoping into a few decades changes that the already

---

issue were to be, for example, higher meat prices as the consequence of measures taken with respect to risks such as mad cow disease etc.).

[6] For a thorough discussion of the complexities of services trade from an economic theoretical perspective see: Brian R. Copeland, "Benefits and costs of trade and investment liberalization in services: Implications from trade theory," in the present volume.

industrialized countries absorbed over a number of generations. Since development itself is an evolutionary process that is still poorly understood, attempts at policy reform/liberalization have often failed, with severe welfare costs to the populations of these countries. This has had repercussions in the industrialized world insofar as civil society organizations have risen to plead the case of those who have been affected, and to criticize the positive and political economics of global capitalism or "globalization" which they hold responsible for these failures and with which the multilateral trading system is strongly identified.

The mechanisms and processes developed to deal with liberalization of industrial goods between industrialized countries may have little relevance to the new issues. Moreover, some of the techniques used to pry industrial goods liberalization out of reluctant legislatures (e.g. the production of *fait accompli* agreements negotiated in secret), which might have made sense in the context of previous rounds that dealt primarily with opening up existing industrial markets, may be counterproductive in the new context.

It is interesting to note that all the trade policy gains in the postwar era (up to and including the Uruguay Round) were realized without noisy opposition in the streets.[7] Equally notably, all further liberalization attempts since the Uruguay Round have met with more generalized opposition.[8] Given the considerations raised above, the emergence of the notion that the trade negotiation process embodies the "democratic deficit" is more likely to reflect the change in the issues being addressed by trade policy than a rebirth of protectionist sentiment in

---

[7] At least not generalized noisy opposition: individual sectors whose interests were threatened in past negotiations were certainly out in force at times during the Uruguay Round and earlier—including Canadian farmers demonstrating on Parliament Hill in 1992.

[8] These include the OECD initiative to create a Multilateral Agreement on Investment (MAI), APEC's Early Voluntary Sectoral Liberalization (EVSL) initiative and the aborted launch of a new round of multilateral trade negotiations at the third WTO ministerial meeting in Seattle.

populations. In other words, a political-economy nerve has recently been hit that was not being hit before.

And the global economic context has evolved

The world has also changed substantially over the past several decades, in part because of the liberalization of trade and investment but for many other reasons as well. Several of these changes are salient for the updated case for trade liberalization.

First, the industrialized countries today, after two decades of supply-side policy, are very different in economic terms than they were at the end of the 1970s following two decades of applied Keynesian demand-management policies. One piece of substantiation for this claim is the nature of the synchronized economic downturn in 2000-2001. As has been noted in many commentaries, this downturn bears greater resemblance to the recessions of the 19th Century, which were triggered by over-investment in a context of very low inflation, than to the recessions of the latter half of the 20th Century, which, for the most part, were triggered by monetary policy restraint to curtail inflationary pressures caused by demand pressures.

Since trade liberalization generates economic growth by increasing efficiency, it was a more powerful tool when the problem facing industrialized economies was excess demand than it is now when the problem is one of excess supply. Moreover, insofar as the policy pendulum swing to the distributional, import-replacement and industrial policies that characterized the 1960s and 1970s was a reaction to the nature of earlier supply-side recessions, the return to supply-side recessions suggests that the headwinds facing liberalization may be stronger now than they have been for some time.

Second, the technological changes that have been driving down the frictional costs of trade (including transportation and communications costs) have also quietly been working to stimulate trade and investment, quite apart from policy change. Given the difficulty of disentangling the effects, it is quite possible that some of the past gains that have been attributed to trade policy have in fact derived from technological change.

Since the frictional costs of trade have been reduced to very low levels as a percentage of the cost of traded goods and services (which accounts in good measure for the comparatively modest impact on trade from the September 11th attacks, which caused frictional costs to rise sharply), their ability to compound gains in trade from policy liberalization appears to have been largely spent. The waning of the gains from this source may be interpreted as reflecting a waning efficacy of trade policy, weakening support for it. For this reason as well, trade policy may be a tougher sell now than it has been for some time.

The empirical case for further gains from trade liberalization

Perhaps the first question to resolve in making the case for further trade liberalization is: What are the commercial gains? Commercial gains are, after all, the immediate objective of trade liberalization; it is to be presumed that, without significant gains in this area, trade liberalization can have little leverage on any related issue.

In theory, the gains from trade liberalization are reflected in increased economic welfare; these gains can be decomposed according to their sources in a general equilibrium framework:

(a) More efficient allocation of factors of production (labour and capital), as predicted by standard trade theory.

(b) Changes in the terms of trade. For individual countries, these can play an important role in determining the net gains from liberalization. World prices change most for those sectors where trade barriers fall the most. Those countries that are net exporters of products that experience price increases enjoy increasing terms of trade, as the world prices of their exports rise relative to the prices of their imports. The reverse occurs for countries specialized in industries where prices fall.

In the standard, static models based on perfectly competitive markets, these are the sources of the gains/losses from trade liberalization. In models that allow for capital flows between

regions, two other sources of gain/loss enter into the calculation:

(c) Welfare gains/losses associated with net capital flows due to changes in relative attractiveness of investment domestically vis-à-vis in other parts of the world. Removal of restrictions on foreign investment can divert capital to countries that previously had relatively high barriers to investment.

(d) Changes in rents earned on foreign direct investment (FDI). Barriers to entry generate rents, some of which accrue to owners of foreign capital. With liberalization, these rents are eroded by competition; thus countries that are important sources of foreign direct investment can lose rental income from liberalization by capital importing countries.

Some models relax the assumption of perfectly competitive markets and constant returns to scale and allow for varying degrees of imperfect competition. These models capture two additional effects from trade liberalization:

(e) Economies of scale effects from production increases arising from trade expansion induced by liberalization.

(f) Reduction of excess profit margins: In imperfectly competitive markets, firms have some degree of market power and thus can markup prices over cost, introducing some monopoly profits into the income accounting (these would be greatest under conditions of pure monopoly, less under oligopolies where there are several large firms, and still less under monopolistic competition where a large number of firms have some degree of market power because of differentiated products). Trade liberalization, by reducing observed markups generates additional economic welfare.

Increasingly, models also build in features that capture some elements of the dynamic impacts of trade expansion on the economy which are thought to be one of the sources of the stronger apparent correlation between trade and growth than the standard general equilibrium models can validate. These effects include:

(g) Capital accumulation driven by the increased savings and investment arising from static gains from trade.

(h) Increased productivity growth: Increased competition can spur innovation that in turn generates productivity growth or that results in additional capital accumulation.

Finally, it should be noted that there is a source of gains from trade that equilibrium models normally do not capture: namely, the dynamic gains that would be associated with increased utilization of resources in economies which are in disequilibrium, where factors of production are not fully utilized and where there is considerable potential demand that is not met due to weak economic performance. [9]

While consideration of the possibility that diminishing returns to openness in already highly open economies such as those within the OECD suggests that the dynamic gains from trade may be lower now than they were during the period on which estimates of the relationship between trade and productivity growth are based, the same is not true of the developing countries that have ample room to expand trade and to garner the dynamic benefits. Insofar as the main gains from trade from the Doha Round are likely to come from north-south flows, the dynamic gains may still be quite large.

A survey of empirical estimates of gains from a new round

Against this background, it is useful to consider the results of empirical studies of the remaining gains from multilateral trade liberalization. Most such studies use general equilibrium models. Due to differences in the structure of the various models that have been used for these purposes, which reflect the efforts of the model builders to capture more realistically particular linkages within and between national economies, the results are rarely directly comparable. Nonetheless, these

[9] For example, tens of millions of people go hungry every day, not because the world economy cannot produce enough food, but because they do not have the incomes to pay for it—i.e. their demand for food is not, in economic jargon, "effective demand". In such conditions, the stimulus from new trade can have powerful multiplier effects throughout the economy.

studies furnish an important starting point for consideration of the possible impacts of further trade liberalization.

Brown, Deardorff and Stern (2001)

A recent study that suggests comparatively large income gains from post-Uruguay Round trade liberalization comes from Brown, Deardorff and Stern.[10] They use the University of Michigan General Equilibrium Model of World Production and Trade (20 countries/18 sectors), which is based on the 1995 Global Trade Analysis Project (GTAP) database. This model features monopolistic competition, product differentiation and increasing returns to scale in the industrial goods and services sectors while retaining a perfectly competitive model for agriculture. To model services sector liberalization, these researchers use estimates of the size of barriers to services trade in a given country based on the difference between gross operating margins of firms in its service sector and the lowest gross operating margin found worldwide, which is assumed to approximate the free trade norm.[11]

This study arrives at a figure for potential gains in world welfare of almost US$1.9 trillion from full liberalization.[12] Of these global gains, almost two-thirds derive from services trade liberalization, with the gains from liberalization going predominantly to the industrialized countries.

---

[10] Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern (2001) "CGE modelling and analysis of multilateral and regional negotiating options." *Discussion Paper No. 468*, University of Michigan.

[11] These estimates were drawn from Bernard Hoekman "The Next Round of Services Negotiations: identifying Priorities and Options", *Federal Reserve Bank of St. Louis Review* 82:31-47.

[12] The income gains in this study are expressed in terms of equivalent variation (which is defined as the amount of money that, if given to consumers at initial prices, would be equivalent to the gain they stand to make from liberalization). The results are presented in 1995 prices, scaled up to be consistent with income levels in 2005, based on an average annual average global income growth rate of 2.5 percent between 1995 and 2005.

The gains from trade estimated in this model are entirely static, there being no capital accumulation or boost to productivity. Moreover, since there are no inter-regional movements of labour or capital, and since trade balances are fixed (i.e., set at the 1995 level), the distribution of gains/losses internationally are entirely the result of changes in the microeconomic structure of each economy induced by liberalization. Because of the absence of dynamic gains, the authors suggest that their results should be considered a lower bound for the size of the overall gains from trade liberalization.

World Bank (2001)

Another recent study that projects comparatively large potential income gains from a new round comes from the World Bank.[13] The simulations are run on the LINKAGE model (15 countries and 20 sectors), which is based on the updated 1997 GTAP data set. The model features constant returns to scale and perfect competition. Non-competitive pricing is allowed for, however, through an exogenous price markup. Moreover, the model incorporates two dynamic features: capital accumulation and productivity growth stimulated by increases in the degree of openness as measured by the sum of exports plus imports as a share of GDP. Finally, the model introduces a time dimension as it is solved forward as a series of linked equilibria; this allows the researchers to generate a time path for income gains under alternative liberalization scenarios.

The World Bank puts forward two scenarios, one with and one without the productivity response to increased trade. The reasonableness of the estimate in the latter scenario depends in

[13] See World Bank, *Global Economic Prospects and the Developing Countries 2002: Making Trade Work for the World's Poor* (Washington D.C.: World Bank, 2001). The discussion of the impact of further trade liberalization is set out in Chapter 6, "Envisioning Alternative Futures: Reshaping Global Trade Architecture for Development".

the first instance on the reasonableness of the assumed responsiveness of productivity to increased openness.[14]

In the first scenario, global income is estimated to be US$355 billion higher in 2015 than in the base case; in the second scenario, the income gain is US$832 billion over the base case.[15] Notably, these gains are limited to those derived from liberalization of industrial goods and agriculture trade alone, with the income gains from agricultural trade

---

[14] The World Bank model breaks down sectoral productivity growth into three components, only one part of which is influenced by openness. Assumptions concerning two parameters are key to the results. The first of these parameters determines how big is the portion of sectoral productivity growth that is influenced by liberalization. In its main results, the World Bank sets this portion at 40 percent, a choice that appears to be have been made based on a judgment by the study's authors as to what is reasonable. The second key parameter is the degree of response of productivity growth to increased openness. In its main results, the World Bank uses an elasticity of one to transmit the effect of increased openness. Empirical support for an elasticity of approximately unity is adduced based on relationships between openness and growth estimated in Sébastien Dessus, Kiichiro Fukasaku, and Raed Safadi, "Multilateral Tariff Liberalisation and the Developing Countries", *Policy Brief No. 18*, (Paris: OECD Development Centre, Paris). The methodology for calculating the dynamic productivity gain is described in endnote 21 of the World Bank study. Table 6.2 at p. 171 of the study provides estimates of the gains with different assumptions about the elasticity and the share of sectoral productivity that is affected by liberalization. The range of gains is from US$355 billion with no productivity stimulus, to US$832 billion with assumptions of 40 percent of sectoral productivity growth being influenced by openness and an elasticity of 1.0 for the productivity gains; and to as much as US$1.34 trillion with assumptions of 80 percent and 1.5 for these two parameters.

One might note in this regard that causality could easily run in both directions: that is, imports of capital equipment or producer services may increase productivity; conversely, increases in productivity due to domestic policies (e.g., improved education, government investment in economic infrastructure) that create exportable surpluses might lead to greater exports that in turn provide the wherewithal to finance imports. When a country has successful strategies, productivity increases go hand-in-hand with increased openness and causality can be hard to sort out.

[15] These gains are measured in terms of equivalent variation, at 1997 prices, scaled to the size of global income in 2015.

liberalization accounting for 70 percent of the total, in both the static and dynamic scenarios.

The World Bank also provides an estimate of the gains from services trade liberalization, but only for developing countries. Here the World Bank study proceeds by assuming that services trade liberalization effectively removes three things:

(a) a "cost penalty" of 10 percent, which reflects the inefficiency of firms operating as monopolies or under protection from outside competition;
(b) a price markup over average cost of 10 percent, which also reflects the weakness of domestic competition; and
(c) a "trade penalty" of 10 percent, which is a tariff equivalent.

Given reforms that remove these three "penalties" simultaneously, developing country income is boosted by some US$884 billion (in terms of income levels in 2015). Adding this possible increase in income to the total gains from liberalization of goods and agriculture trade as per the dynamic scenario raises the total gains in 2015 from full liberalization to US$1.7 trillion—without even taking into account gains from services liberalization in the developed countries.

The final noteworthy feature of the World Bank simulations is that the time path for liberalization is modeled by solving the model sequentially from a post-Uruguay Round data set in 2005 forward to 2015. In its full liberalization scenario, the World Bank reduces protection by one-sixth in each year from 2005 to 2010; completion of the adjustment to these reductions takes place over the period 2011-2015. The increments to global income thus can be assessed in each year. Added up and reported in present value terms as of 2005 (using a real discount rate of 1.5 percent), the cumulated additional income in the first scenario amounts to US$1.5 trillion to the developing countries alone, and US$2.8 trillion globally.

Dee and Hanslow (2000)

While the above studies provide some benchmarks for comparatively high estimates of the gains from further liberalization, Dee and Hanslow project the world as a whole to

be better off by only about US$260 billion annually as a result of eliminating all post-Uruguay Round trade barriers.[16]

These researchers use the FTAP general equilibrium model, which is based on the 1995 GTAP data set, updated to reflect the Uruguay Round's removal of some of the barriers to trade. The model introduces bilateral foreign direct investment and capital accumulation, which adds some dynamic effects into the results. One feature of the way in which capital flows are modeled is that capital shifts more readily between economies within a given sector than across different sectors within a given economy. A second feature of this study is that it deploys a newly developed set of estimates of barriers to trade in services,[17] and distinguishes between barriers to entry in services through FDI versus barriers affecting other modes of services delivery. The latter feature allows this empirical study to illustrate certain features of liberalization suggested by theory, namely that (a) liberalizing some channels of services delivery but not others creates distortions that can actually worsen real incomes; and (b) some countries that invest in services industries abroad lose rents when these foreign countries liberalize their services sectors.

Of the total US$260 billion of income gains projected by Dee and Hanslow, about US$50 billion comes from agricultural trade liberalization and US$80 billion from the liberalization of manufactured products. As in the World Bank and Brown-Deardorff-Stern studies, the largest gains come from services trade liberalization. However, Dee and Hanslow put the gains here at a comparatively modest additional US$130 billion.

---

[16] See Philippa Dee and Kevin Hanslow, "Multilateral Liberalization of Services Trade," Productivity Commission Staff Research Paper, Ausinfo, Canberra (2000).

[17] These estimates are based on results of studies on banking and telecommunications services. Dee and Hanslow model the barriers to trade as markups of prices over costs. Liberalization accordingly removes rents.

Hertel (2000)

Thomas Hertel used the standard GTAP model, based on the 1995 GTAP data set, aggregated into 19 regions and 22 sectors, and scaled to a 2005 income base to model post-Uruguay Round liberalization.[18] The model has a standard structure, assuming constant returns to scale and perfect competition.

One notable feature of the simulations reported here is that the standard GTAP trade elasticities were doubled; this was done in part because historical simulations tracked actual developments better with higher elasticities and in part because of the longer time frame contemplated in this scenario (10+ years versus the usual 3-5 years on which the medium-term elasticities were based).[19] Hertel reports that doubling the elasticities approximately doubles the size of the gains.

A second notable feature of Hertel's estimates is that the barriers to services trade are modeled quite differently than in Dee and Hanslow. Hertel models protection as raising costs to the foreign firm seeking to enter the domestic market. Liberalization is then modeled as a change that reduces the cost of imports by the equivalent amount. As Dee and Hanslow point out, this approach to modeling protection tends to yield larger measures of economic welfare gain than modeling protection as enabling domestic firms to earn rents. At the same time, Hertel applies this approach only to the construction and business and financial services sectors.

The gains are estimated by Hertel to be US$350 billion, with the major contributions deriving from the liberalization of agriculture (US$164 billion), manufacturing (US$130) and services (US$55 billion), in that order.

---

[18] Thomas Hertel, "Potential Gains from Reducing Trade Barriers in Manufacturing, Services and Agriculture," 24th Annual Economic Policy Conference, Federal Reserve Bank of St. Louis, Oct. 21-22, 1999.

[19] See Hertel, op. cit., p. 82, footnote 7; and also discussion on p. 90.

Francois (2001)

Joseph Francois uses the GTAP model (aggregated to 9 countries and 19 sectors) to examine the impacts of a new round. [20] The model is based on the 1995 GTAP data set, updated to reflect post-Uruguay Round levels of protection. The model allows for capital accumulation, scale economies and imperfect competition. Services barriers are modeled as raising costs to the exporting firm.

The study takes into explicit account the following issues:

(a) the fact that the bound tariffs which are under negotiation in the round are substantially higher than applied tariffs in many developing countries (which can result in overstated impacts under partial liberalization scenarios);

(b) market structure matters: gains under liberalization are smaller where firms have increased market power.

Francois' results (presented in 1995 prices and calibrated to 1995 income levels) suggest global income gains between US$175 billion and US$385 billion, annually, for a 50 percent reduction in protection, split more or less evenly between developed and developing countries, with about two-thirds of the gains coming from reductions in tariffs on industrial goods.

Comparing the results

In summary, one can point to a number of studies that predict that post-Uruguay Round trade liberalization will increase real global income.[21] However, there are obvious problems in

[20] See Joseph Francois, *The Next WTO Round: North-South stakes in new market access negotiations* (Adelaide: Centre for International Economic Studies, University of Adelaide and Tinbergen Institute, the Netherlands, 2001).

[21] In addition to the five studies reviewed above, several other studies have suggested gains from further liberalization within the same range. For example, a study commissioned by the Australian Department of Foreign Affairs and Trade in 1999 suggested that full elimination of trade barriers would generate income gains totaling US$750 billion, with one-third of this coming from goods and agriculture trade liberalization and the two-thirds

interpreting this body of work because of the differences in models, differences in aggregation, differences in the data sets used to generate the simulations (including importantly differences in the measures of effective protection in the services sector), as well as differences in the size of the global economy to which the results are calibrated. While a detailed reconciliation of the results is not possible, a few basic, if crude, adjustments to the reported results go a long way toward making them somewhat more comparable.

Table 1 below summarizes the main results from the Brown-Deardorff-Stern (BDS), World Bank (WB), Hertel, Dee-Hanslow (DH) and Francois studies for liberalization of industrial products, agriculture and services separately (we include the breakdowns provided by the studies for services liberalization gains by developing and developed countries separately). We focus on the scenarios for full liberalization where these are available (only the Francois study does not provide a simulation for full liberalization), and ignore other elements of these studies (i.e., interactions between liberalization in the different sectors, which tend to affect the

---

from services trade liberalization. See Department of Foreign Affairs and Trade, *Global Trade Reform: Maintaining Momentum* (Commonwealth of Australia, 1999); available at http://www.dfat.gov.au. A study by Nigel Nagarajan projected gains of US$400 billion, with the gains obtaining from trade facilitation and across-the-board tariff reduction; plus an additional US$85 billion from an agreement on competition. Nigel Nagarajan, "The Millennium Round: An Economic Appraisal," Economic Papers No. 139, European Commission, DG for Economic and Financial Affairs, November 1999. Finally an OECD study that examined liberalization of industrial and agricultural products only reported very small results for simulations without productivity-enhancing effects from openness (US$82 billion in 1995 prices, equivalent to 0.2 percent of 2010 incomes); but quite substantial gains, US$1.2 trillion, equivalent to 3.1 percent of global incomes, in 2010, when dynamic productivity effects were introduced. See Sébastien Dessus, Kiichiro Fukasaku, and Raed Safadi, "Multilateral Tariff Liberalisation and the Developing Countries", *Policy Brief No. 18*, (Paris: OECD Development Centre, Paris). This latter study used the OECD's Trade Policy Simulation Model, a modified version of the LINKAGE model that generated the World Bank results reported earlier; the OECD model was based on the 1995 GTAP data set.

totals somewhat, and additional effects such as possible gains from trade facilitation and competition policy, which the Francois study includes).

Table 1: Selected Empirical Estimates of the Income Gains from a new Round of Multilateral Trade Negotiations

	BDS	WB	Hertel	DH	Francois	
Income levels in:	2005	2015	2005	1995	1995	
Base year for prices:	1995	1997	1995	1995	1995	
					A	B
Goods	633	245	130	80	117	190
Agriculture	32	587	164	50	21	27
Services (Total)	1,224		55	133	42	63
- Industrial countries	988		40	-2	23	28
- Devel. countries	236	884	15	135	19	35
Total	1,889	1,716	349	263	180	279

Notes: (1) Totals are calculated from the individual elements and differ somewhat from the totals reported in the studies, which include interaction effects. (2) The World Bank results are taken from the scenario in which productivity responds to increased openness; the World Bank did not estimate gains from services trade liberalization in the industrialized countries. (3) The Dee-Hanslow figures for gains from liberalization of agriculture and industrial goods trade are taken from the text; in the tabular presentation, these results are combined and sum to US$133, slightly more than the rounded figures reported in the text and shown in the table above (4) For the Francois study, Column A reports the scenario based on oligopoly market structures and 50 percent reduction of applied rates. Column B reports the scenario based on monopolistic competition and 50 percent reduction of applied rates. The figures for services liberalization in the industrialized countries in the Francois scenarios are the sum for the United States, the European Union and Japan only. The "rest of the world" is lumped in with the developing country total. Accordingly the split shown here overstates somewhat the gains for developing countries from services liberalization since the totals for some of the smaller industrialized countries are buried here.

Based on the information provided in the studies, we scale back the results to 1995 prices and 1995 income levels. These data are shown in Table 2. This allows a calculation of the average results for liberalization within each of the sectors. Two averages are presented: the simple average of the estimates of liberalization in each of the sectors by the five studies and a

corresponding set of averages discarding the high and low estimates for each sector.

Table 2: Standardized results based on 1995 prices and 1995 income levels, and averages

	BDS	WB	Her	DH	Fra	**Ave**	%of GDP	**Ex hi/lo**	% of GDP
Goods	495	122	88	80	307	**218**	0.8%	**172**	0.6%
Ag	25	292	111	50	48	**105**	0.4%	**70**	0.2%
Services	956		37	133	105	**377**	1.3%	**163**	0.6%
- Indust.	772		27	-2	51	**212**		**39**	
- devel..	184	439	10	135	54	**164**		**124**	
Total	1,476	853	237	263	459	**700**		**405**	
% of inc.	5.2%	3.0%	0.8%	0.9%	1.6%	**2.5%**		**1.4%**	

Source: Calculations by the authors. Notes: (1) The BDS estimates are scaled back to 1995 based on the 2.5 percent average annual income growth given in the study (at p. 6). The World Bank figures are scaled back to 1997 levels based on scaling factors kindly provided by Dominique van der Mensbrugghe of the World Bank. They are then scaled back to 1995 income levels and prices based on global growth between 1995 and 1997 and U.S. price growth over the same period. The Hertel estimates are scaled back to 1995 based on information supplied in Dee and Hanslow (see footnote 3, p. 17) in respect of a reconciliation of the DH results with Hertel's results for industrial products. For the Francois study, we take the average of the two scenarios and double the figures to roughly approximate full liberalization; since CGE model results tend to be roughly linear, these figures are probably not unrepresentative of the results for full liberalization from this model; however, these figures should be treated as notional.

The overall size of the remaining gains from trade (these are all notionally 100 percent liberalization scenarios) is quite modest. Measured in 1995 dollars and scaled to 1995 global income levels, full liberalization would generate US700 billion additional income (equivalent to about 2.5 percent of global GDP), if one takes the simple average of the gains for each sector from these five models. If one excludes the highest and lowest estimate for each sector, the average gain falls to a little over US$400 billion, equivalent to 1.4 percent of global GDP (the difference is largely the result of excluding the remarkably

large gains from services liberalization by industrialized countries in the Brown-Deardorff-Stern simulation).

Scaled up to the context of the global economy in 2002 (projected by the IMF to be about US$31.9 trillion), the remaining potential gains from full liberalization would amount to about US$790 billion going by the higher average and a little over US$450 going by the more conservative average that excludes the outlier estimates. The extent of liberalization that will be achieved in the Doha Round will be a fraction of this amount.

Assessment of the results

How realistic are these estimates and what are their implications for the case for further trade liberalization?

First, with regard to goods trade, one set of questions concerns the post-Uruguay Round level of tariffs. Over the eight previous trade rounds, average tariffs were lowered from about 40 percent to less than 4 percent.[22] The World Bank estimates that the average tariff in high-income countries on imports from other high-income countries is only 0.8 percent and on imports from low-income countries is only 3.4 percent.[23] These low figures represent the average taken over a very large number of tariff items. For the large majority of products, duties range from small to negligible. A comparatively small number of items face intermediate tariffs that are neither trivial nor prohibitive (the vast majority of these now are in developing country tariff schedules). A small number of items face prohibitively high tariffs, including those facing intermediate tariffs within tariff rate quota (TRQ) limits and prohibitively high tariffs beyond those limits (most TRQs are in agriculture). The behavioural impact in changing trade flows by reducing

[22] These are representative figures, as cited in: European Commission, "A new round for harnessed, equitable globalization" (Brussels: European Commission, October 2001) p. 4

[23] Source: World Bank, *Global Economic Prospects 2001* (Washington D.C.: World Bank, 2001).

small to negligible tariffs by some fraction is probably negligible. Similarly, reducing a prohibitively high tariff by, say, one-third may still leave the tariff prohibitively high and thus induce no trade response whatsoever. The bulk of the gains from trade in a new round derived from amendments to tariff schedules must therefore come from the comparatively small number of items facing intermediate tariffs, restrictive tariff rate quotas or tariff spikes. It is fair to conclude that, to have a quantitatively significant impact, the Doha Round will require deep and comprehensive cuts in effective protection.

Second, the notion that there are major gains to be had from liberalization of agricultural trade finds little support from the studies surveyed above.

Third, tariff cuts agreed in the WTO are with respect to tariff bindings. Insofar as many developing countries that have high tariffs are operating well below their bound rates, cuts to bound rates have no behavioural implications either.[24] For example, India, which enters the current round with one of the higher tariff walls, bound 67 percent of its tariff lines in its Uruguay Round commitments, including all of its agricultural tariffs and 62 percent of its industrial tariffs. The ceiling bindings of 40 percent *ad valorem* for finished goods and 25 percent on intermediate goods, machinery and equipment, are to be phased in by 2005. However, already by fiscal year 1995-1996, India had unilaterally reduced its applied tariffs from a weighted average of 87 percent in FY1990-1991, when its structural reforms began, to 25 percent in FY1995-1996. At the same time, the peak rate of duty had fallen from 355 percent in

[24] Joseph Francois has pointed out that past empirical studies have sometimes overstated the impact of liberalization by failing to take account of what he terms a "tariff binding overhang", namely the fact that bound tariffs are often well above applied tariffs and cuts to the bound rates (or introduction of bound rates at levels well above applied rates) have no impact on trade flows. See Joseph Francois, *The Next WTO Round: North-South stakes in new market access negotiations* (Adelaide: Centre for International Economic Studies, University of Adelaide and Tinbergen Institute, the Netherlands, 2001).

FY1990-1991 to only 50 percent by FY1995-1996.[25] As can be seen, India's unilateral liberalization proceeded much faster and went much deeper than was committed to in the WTO. This means that further liberalization in a new round of about 50 percent would be needed simply to lock in the current comparatively low tariff levels, and even deeper liberalization would be required to actually force applied rates down further.[26] Clearly, this will mean especially large reductions in bound tariffs within the developing countries in order for these reductions to actually constrain applied tariffs.

Fourth, the range of estimates of the gains from services sector liberalization is too great to allow meaningful conclusions to be drawn from these, still early, quantitative

---

[25] See, Rajesh Chadha, Drusilla K. Brown, Alan V. Deardorff and Robert M. Stern, "Computational Analysis of the Impact on India of the Uruguay Round and the Forthcoming WTO Trade Negotiations," Working Paper 2001-2007, Tufts University 2001. This study found an economic welfare gain for India from the Uruguay Round of 1.1 percent of its projected GDP in 2005. The interesting question, given India's pace of unilateral liberalization, is whether the gains are properly attributable to the negotiated settlement. There is one specific area where the Uruguay Round settlement appears more clearly to have been instrumental; that is in accelerating elimination of quantity restrictions that India maintained on the justification of balance-of-payments concerns. Shortly after the formation of the WTO, a challenge to these quantity restrictions, led by the United States, was mounted in the WTO's Balance of Payments Committee and subsequently came before the Dispute Settlement Body. In a WTO Appellate Body Report, which was adopted by the Dispute Settlement Body on September 22, 1999, India's quantity restrictions were found to violate its commitments. As a result of this report, India entered into consultations and agreed to phase out its restrictions somewhat earlier than planned. See WTO Appellate Body Report: *India Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, AB-19999-3, WT DS90 AB R (99-1329).

[26] There is one modest benefit from introducing new bindings at or above applied rates: this increases certainty about the possible range of future tariffs, since bindings make it more difficult for countries to resort to tariff increases to reduce external competitive pressures on particular industries. Reducing uncertainty is generally good for business planning so there may be a non-price effect associated with such bindings.

results (for example, as shown in Table 2 above, excluding outlier estimates changes the averages dramatically). Since the actual instruments of services protection are not modeled, a lot rests on the inferred levels of protection for different services sectors in the various economies and on still unresolved questions of how to model the protection. In short, this is the area where the estimates are most tenuous, where the results are to the greatest extent driven by the assumptions, and where the assumptions have the least amount of empirical validation.

Fifth, the fact that most of the models surveyed here incorporate one or another feature(s) to pick up additional gains from trade implied by theory that the standard, static, perfectly competitive models do not, and/or to better replicate historical growth of trade (e.g., doubling the standard trade elasticities as some researchers have done), it is not clear how tenable it is to hold that there remain nonetheless very large gains still to be identified.[27]

Sixth, the results of the Uruguay Round are of some relevance in calibrating our expectations of what is realistic to expect from the Doha Round. Several recent studies arrive at comparatively low estimates for the economic welfare gains from that round. The Çhadha et al. study puts the gains at US$160 billion in 2005, based on an expansion of trade of

[27] This is especially the case if the weight of the argument that much remains unaccounted for comes to rest on total factor productivity (TFP). TFP is not itself a directly measured variable but an artifact of quantitative growth accounting—the unexplained residual after known contributions to growth have been accounted for. Moreover, it is product of the particular economic model and assumptions that underpins the growth accounting. For example, for given countries, it is a modeler's choice whether to constrain the model to constant returns to scale and obtain significant TPF contributions to growth or, by removing the constraint of constant returns, to allow the model to perhaps assign the growth to increasing returns. While it might be reasonable in this context to include an exogenous boost to productivity in models that assume constant returns, to do so in models that build in increasing returns and capital accumulation might well be to double-count.

US$148 billion or about 2 percent of global trade.[28] The Brown-Deardorff-Stern study cited earlier puts the gains at half that—only US$75 billion annually. Taking into account the scaling issues, these gains fall well short of those that would be projected for the Doha Round on the assumption of a one-third reduction in protection. In other words, studies of post-Uruguay Round trade liberalization tend to project substantially greater expansion of trade and GDP from a new round than probably was leveraged by the Uruguay Round. Given that liberalization gets progressively tougher with each round, this suggests that some degree of caution is warranted in building up expectations concerning what may be feasible.

Finally, there is no consensus across the studies concerning the distribution of gains amongst the contracting parties. A comparison of the distribution of gains is made difficult by the differences in aggregation of countries in the models surveyed, as well as by the differences in model features, some of which (e.g., including foreign direct investment) can have very significant implications for the net results, as shown by the Dee-Hanslow and other studies that include such effects. At the same time, these results do highlight the risk that some parties might lose under some scenarios. Accordingly, one reasonably broadly shared conclusion amongst researchers in this area is that it will be important for liberalization to proceed on a broad front to minimize risks of some parties walking away as losers.

---

[28] See, Rajesh Chadha, Drusilla K. Brown, Alan V. Deardorff and Robert M. Stern, "Computational Analysis of the Impact on India of the Uruguay Round and the Forthcoming WTO Trade Negotiations," op. cit.. Note: the Chadha et al. findings with regard to the extent of trade expansion appear to be in the same general ballpark as a recent estimate of the GDP gains from the Uruguay Round made by the U.S. Council of Economic Advisors. The Uruguay Round gain was estimated at 0.4 to 0.6 percent of GDP, well below the 0.9 to 1.7 percent of GDP several years earlier. See Council of Economic Advisors, 1999, "America's Interest in the World Trade Organization: An Economic Assessment," Washington, D.C.: The President's Council of Economic Advisors.

Clearly, the numbers presented in these studies do not settle the issue of the extent of the remaining gains from trade. Can it nonetheless be concluded, based on the above analysis, that the commercial gains support the commitment of resources to negotiate and implement a new multilateral round of trade negotiations?

There are several considerations that argue in the positive.

First, even if the gains from a new round measurable in general equilibrium models fall at the lower end of the spectrum (i.e. about 0.3 percent of global GDP by the middle of the next decade based on a one-third cut to protection), which is to say even if the gains are no greater than the estimates for the Uruguay Round suggest, the central presumption is nonetheless some net gain at the margin.

Second, a round is needed to broaden the basis of negotiations to realistically permit any forward movement in the agriculture and services negotiations, which individually probably cannot offer sufficient trade-off possibilities to yield significant results on their own. By the same token, a broader round is needed to improve the prospects that all will share in the benefits.

Third, treated in a cost-benefit framework, the net benefits from a round must be evaluated on the basis of a higher income stream less the investments required to generate it. Taking into account the fact that social rates of return that would be used to discount future incomes are usually taken to be low, income gains made over the next two decades would not be heavily discounted. The World Bank study noted earlier undertakes such a present-value calculation based on the scenario in which income is US$355 billion higher in 2015. As noted, this calculation yields a present value of US$1.5 trillion to developing countries alone, and global gains of US$2.8 trillion from additional trade over the period to 2015 based on the hypothesis that an agreement is reached in 2005. These results are not at all out of line with the average results reported above.

The net resource costs to achieve this gain are not particularly large. This reflects the fact that the machinery of trade policy administration is already in place. The use of this machinery for negotiations represents, in good measure, increased utilization of existing capacity. For developing countries, where the highest opportunity costs could be argued to exist, negotiating costs are subsidized both by official trade-related assistance and potentially by the informal advocacy of the network of civil society organizations that constitute what has been called a "virtual secretariat" for the developing countries.[29] Finally, as regards implementation costs, similar arguments prevail. Moreover, in the latter case, institutional reforms implemented to support trade often are needed for domestic economic development in any case.[30]

The case of *relative* legitimacy[31] of further liberalization can therefore be upheld, particularly if least-developed WTO members avail themselves of the many opportunities to "free ride" on the intellectual capital developed on their behalf by more advanced developing countries that have more ample

---

[29] The term is taken from Sylvia Ostry, "The Uruguay Round North-South Grand Bargain: Implications for Future Negotiations," paper presented at the conference, entitled: *The Political Economy of International Trade Law*, which was held at the University of Minnesota Law School, from September 15 to 17, 2000. For a discussion of the positive role that civil society can play in trade policy formulation, see, John M. Curtis, "Trade and Civil Society: Toward Greater Transparency in the Policy Process" in Trade Policy Research 2001, (Ottawa: Department of Foreign Affairs and International Trade, 2001), pp. 295-321. Whether or not developing countries will make use of this potential is another question. CSOs reportedly had little impact on developing country positions at Doha. Source: personal communication from Guy de Jonquières of the *Financial Times*.

[30] It is also quite possible that liberalization, by reducing the height of effective barriers to trade, also reduces the incentives to try and avoid them and, by the same token, reduces resource requirements for enforcing policies.

[31] The importance of taking this into account was stressed by Pierre Jacquet of the Institut Français des Relations Internationales at the conference *Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium*, Harvard University (June 1-2, 2000).

resources, as well as by the international network of policy CSOs.

The above discussions indicate that there is no clear-cut answer as to what the commercial benefits would be, or even necessarily from which quarter they might arise. At the same time, the weight of the evidence suggests that some gains in income can be realized under reasonable assumptions about the extent of liberalization. The gains are likely to be incremental, not transformational in scale but, especially seen in a longer-run cost-benefit context, worth the pursuit. Most importantly, many considerations point to the importance of the Doha Round eventually living up to the billing that some have suggested, namely that it be a "development round." Indeed, the evidence suggests that, if it is *not* a development round, its contribution will be marginal at best.

Maintaining the balance between regional and multilateral liberalization

The modern trade system is, in essence, a patchwork of multilateral, regional and bilateral arrangements, broadly, although not fully, consistent with each other. Some regional arrangements, such as the European Union, NAFTA, or the Australia-New Zealand Closer Economic Relations (CER), are deeper and more complete than others, such as Mercosur, the Andean Pact or ASEAN. Also to be taken into account is the proliferation of bilateral initiatives, which number in the hundreds (including signed agreements and negotiations toward an agreement). Canada alone, for example, has recently concluded a free trade agreement with Costa Rica and is actively exploring similar arrangements with the Central American "four" (Guatemala, Honduras, El Salvador and Nicaragua), as well as with Singapore.

The literature on regional trade agreements focuses mainly on the issue of the relative degree of trade diversion versus trade

creation.[32] Regional preferential arrangements that create enough trade to more than compensate those countries that face some measure of trade diversion are generally considered to be beneficial. Arrangements that result mainly in trade diversion would be considered undesirable. The current consensus on existing regional trade arrangements is that, on balance, they are positive, creating more trade than diverting it and providing "building blocks" for larger, potentially worldwide or multilateral arrangements, or serving as "stepping stones" to faster liberalization, rather than constituting "stumbling blocks" to the promotion of freer global trade.

They do, however, pose certain risks. Standards and norms can vary from agreement to agreement, including different rules of origin, which complicate matters for business. As well, difficult issues—be they services, agriculture or government procurement—are often not dealt with in regional negotiations. Rather, they are left to the multilateral sphere to be resolved. Accordingly, parallel progress in the multilateral sphere is an important complement to the effective functioning of the regional agreements.

Moreover, with regional preferential trade arrangements, it might be said that "what goes around, comes around": specifically, the success of some countries in creating preferential access to important markets can over the long term erode the growth prospects for those disadvantaged by such deals—this might be true, even if the regional or bilateral trade agreement were, on balance, trade-creating for all. Canada was successful in negotiating an FTA with the United States but then had to prevent being "hubbed and spoked" when Mexico sought a similar arrangement with the United States—hence the

---

[32] The identification of this issue goes back to the work of Jacob Viner. A recent survey of this issue is also provided in T. Cottier, "The Challenge of Regionalization and Preferential Relations in World Trade Law and Policy," *European Foreign Affairs Review*, V. 2, 1996, pp. 149-167. See also, F. Roessler, "The Relationship between Regional Integration Agreements and the Multilateral Trade Order," in K. Anderson and R. Blackhurst, (eds.), *Regional Integration and the Global Trading System*, Harvester Wheatsheaf, 1993.

NAFTA. The EU has many trade arrangements now in place; the Mexico-EU FTA is but the latest significant extension of this system of preferences that does not include Canada, which has left Canada effectively, together with a handful of other countries, in a position of "least favoured nation" in European trade. Over the longer term, this appears to be a factor in the gradual decline in importance of the EU in Canada's trade. Mexico is also pursuing other arrangements in the Americas, which emphasizes the importance of advancing the FTAA negotiations to maintain Canada's market position in the western hemisphere.

Furthermore, there are additional complexities in evaluating preferential trading arrangements—do they, for example, impact on the way that the forces of comparative advantage shape the economies that enter into these deals and, if so, is this actually of benefit to the parties? The World Bank, which is an enthusiastic supporter of trade liberalization as the linchpin of development strategies for poor countries, has recently provided an extensive cautionary note about the risks that regional arrangements could pose and offers the following advice: "Smaller countries with less technical capacity to evaluate these schemes may find themselves at a net disadvantage, and be better off with first-best unilateral trade reform."[33] In other words, while liberalization is good, preferences are potentially damaging. One might also contrast the virtual absence of regional preferential arrangements in East Asia, which has had the greatest developmental success, and the proliferation of such arrangements in Latin America and Africa.

Arguably, regional liberalization works best if the narrower but deeper liberalization that is possible regionally is complemented by multilateral liberalization that reduces the margin of preference that regional liberalization creates. This nonetheless leaves the margin of preference for domestic production reduced, which is the main source of structural economic benefit. In this context, maintaining the pace of

[33] See World Bank, *Global Economic Prospects and the Developing Countries 2002: Making Trade Work for the World's Poor,* op. cit., p.154

multilateral liberalization is important for the longer-term efficiency of the global structure of production.

Further, and specifically in Canada's case, it is sometimes hard or impossible to deal with our most important trading partner by far, the United States, on strictly bilateral terms; we need allies from around the world to make it worthwhile for the United States to offer concessions to us on some key issues such as government procurement or certain aspects of agriculture, even in areas of direct Canada-United States interest.

At the present time, given that the deepening of integration within Europe (primarily due to its common currency) has expanded the effective margin of preference for its domestic participants, a round is needed to keep Europe firmly anchored in the multilateral regime. The phenomenal rise of trade within North America and the consequent relative weakening of trade ties across the Atlantic and Pacific also raise longer-term geo-economic and geopolitical risks that a multilateral round would at least partially counter.

The Doha Declaration includes, at paragraph 29, a commitment to clarifying and improving disciplines and procedures under the WTO provisions that apply to regional trade agreements. The most important discipline, however, would be further substantial multilateral liberalization that effectively reduces the margins of preference that regional agreements can provide.

Other Issues

Trade negotiations are not open-ended affairs: they are circumscribed more or less tightly by the negotiated terms of reference for the round. The main gains from trade will derive from the extent to which the commitments in the three main areas, industrial products, agriculture and services, are translated into market opening and/or reduction of market distortions. There are, in addition, a large number of trade-related issues to be dealt with in the Doha Round, either in terms of negotiations or as work programs, or both. The contribution to economic growth from addressing these issues is

less direct, although, in the longer run, they are important to the efficiency of the global economy. These issues include:

- trade-related aspects of intellectual property rights (TRIPs);
- the relationship between trade and investment;
- the interaction between trade and competition policy;
- transparency in government procurement;
- trade facilitation;
- rules on subsidies and countervailing measures;
- disciplines and procedures applying to regional trade agreements;
- certain aspects of dispute settlement;
- trade and the environment (including *inter alia:* negotiations on the applicability of WTO rules as among parties to multilateral environment agreements; and study within the Committee on Trade and Environment of the effect of environmental measures on market access and labeling requirements for environmental purposes);
- electronic commerce;
- issues related to the integration of small, vulnerable economies into the multilateral trading system;
- the relationship between trade, debt and finance;
- trade and transfer of technology to developing countries;
- technical cooperation and capacity building (including through the Integrated Framework);
- least-developed country concerns.

Unlike mutual tariff reductions, many of these issues do not afford "win-win" solutions. Hence, the frictions in these areas can only be addressed multilaterally in the context of a broad package that permits tradeoffs. Periodically, a round is needed to allow these issues to be addressed.

Conclusions

Promoting trade liberalization has not been easy for some time now. In good measure, this reflects how far the global trading system has moved toward the theoretical norm of free trade. Liberalization in the comparatively non-problematic industrial

sectors has resulted in the realization of much of the dynamic gains from openness and, through spillover effects, some of the gains in non-liberalized sectors such as agriculture and services. Moving an already highly open global economy to a somewhat more open posture by liberalizing in the more problematic areas results in a more complex accounting of benefits, adjustment costs and risks than was faced in the early rounds of the post-WWII period.

Putting aside the sometimes exaggerated claims and counterclaims of benefits/damages from trade and investment that have emerged from the escalation of rhetoric about globalization, a qualified case can be made that the Doha Round has the potential to yield a positive balance of benefits.

To a large extent, this result depends on the Doha Round being a "development round" as advertised and hoped for. That is to say, the main benefits from trade at this juncture lie in stimulating trade with presently marginalized economies. These are the countries which:

- tend to have medium-level tariffs whose reductions are most likely to stimulate trade,
- accordingly also need market access abroad to pay for increased imports but which themselves tend to face medium-level tariffs or binding tariff-rate quotas; and
- stand to reap, probably by far, the largest dynamic benefits from becoming more open.

If the exchange of benefits is largely limited to within the OECD, the gains will be hard to detect. This largely reflects the fact that, within this group of countries, tariffs facing other members of the group are either small or prohibitive. Accordingly, even impressive cuts in percentage terms will have little in the way of practical implications for trade flows. In services and agriculture, where the greatest untapped gains are suspected to lie, the quantitative studies have yet to present a truly compelling case, confidence in the supporting analysis is weaker, the surrounding issues are more complex, and the likelihood of rapid movement is consequently less.

In systemic terms, the multilateral round can usefully counterbalance the distortionary aspects of regionalism, as well

as deal with some of the frictions and irritants that accumulate between rounds. These gains are hard to quantify but stand there as offsets to the largely unrecognized adjustment costs of liberalization.

It is important not to oversell the potential gains from the new round. Playing with numbers, the very same estimate of the gains from the round can be presented as impressively large or sufficiently small to make one wonder what all the fuss is about.[34] The important point in public policy terms is that it likely is an incremental gain and more than likely to pay for the resource costs involved in negotiation and implementation.

The messaging on trade liberalization must evolve

The issues today are subtler than they were in the past. It can be argued, therefore, that the messaging on trade needs updating —on both sides of the globalization debate.

The conventional framing of globalization issues focuses on the disruptive aspects of economic growth through competition (structural change and labour market transition); the undermining of regulatory safeguards (including environmental) due to the pressure from fast-paced economic change and external regulatory competition; the widening of income gaps between the rich and the poor, within societies as well as between countries; and the potential in a trade-integrated world for domestic economies to be destabilized by events beyond their borders.[35] With the trade policy community and anti-

[34] For example, as shown by the World Bank, summing 10 years' worth of increments to global income from a new round and discounting back to the present using a low social rate of discount yields a global income gain of US$2.8 trillion from a liberalization scenario in which annual income in 2015 is only US$355 billion higher than it otherwise would have been. The very same impact estimate, presented as the increase in income in 2015 for an average income earner, would represent enough to take a family of four out to dinner and a movie. For a person in a developing country living on a dollar a day, the implied gain would be a few dollars.

[35] As an example of one such articulation, see the European Commission's recent "argumentaire" for the Doha WTO ministerial

globalization activists locked into adversarial positions over this construction of the issues, it would make sense from this perspective alone to update how we frame the issues so as to possibly facilitate the emergence of a new consensus.

More fundamentally, the procedures of trade liberalization probably should be reconsidered. The point is not that we need a change of heart about trade, but we may need a change of art and quite possibly a change of pace of liberalization.

meeting: *A new round for harnessed, equitable globalization* (Brussels: European Commission, October 2001).

Part II:

Trade in Services: A Survey of the Issues

Benefits and Costs of Trade and Investment Liberalization in Services: Implications from Trade Theory

Brian R. Copeland*

Introduction

In Canada, the service sector of the economy accounts for about 73 percent of total employment, but only about 14 percent of international trade.[1] That is, although most workers produce services, most international trade is in goods. This disparity suggests that there may be potential for further gains from trade in services. During the Uruguay Round of trade negotiations that led to the World Trade Organization (WTO), member countries set up a structure for multilateral trade negotiations in services, the General Agreement for Trade in Services (GATS). Since negotiations to open international service markets further will be proceeding under this umbrella, it is important that we develop an understanding of the ways in which service trade liberalization may benefit the economy, as well as some of the possible pitfalls.

The purpose of this chapter is to consider the implications of international trade and investment theory for the benefits and costs of trade liberalization in the service sector. Although there will be some attention given to empirical evidence and to policy implications, the main focus of this paper is conceptual. There are numerous policy and legal studies and several empirical

* The author is with the Department of Economics, University of British Columbia. This paper was prepared for the Department of Foreign Affairs and International Trade, Government of Canada. The views in this paper are those of the author. Author's address: Department of Economics, 997-1873 East Mall, University of British Columbia, Vancouver, B.C. V6T 1Z1 Canada. E-mail: copeland@econ.ubc.ca

[1] See Roy (1998); the figures are from Statistics Canada.

reviews available;[2] however, there has been relatively less attention given to an assessment of the implications of the recent international trade-theory literature and the ways in which it needs to be further developed to deal with some of the particular issues in service trade that differ from goods trade.[3]

The structure of the paper is as follows. First, I review some general issues regarding the differences between goods and services trade, touching on issues raised by the intangibility of services, the importance of physical presence of client and service provider, the possibility of embodied versus disembodied factor service trade, the significance of public provision of some services, the complexities raised by regulation of domestic services, and the heterogeneity of services.

Then I review the theoretical literature on trade and investment in services, touching along the way on salient aspects of the theories of comparative advantage and factor-price equalization (including substitutability or complementarity between trade in goods or service, and trade in factor inputs), income distributional issues, and the insights generated by allowing for various refinements of the basic models of trade such as product differentiation, scale economies, imperfect competition, foreign direct investment, agglomeration effects, dynamic gains from trade and investment, and market power effects. As well, I identify some important gaps in the literature.

In the fourth section of the paper, I discuss the implications of trade theory for the benefits and costs of trade and investment liberalization in services, drawing on a simple theoretical framework, which is included in the appendix. Some of the issues addressed here are: terms of trade effects, the welfare implications of piecemeal liberalization (including differences from liberalizing the different modes of supply), spillover effects of piecemeal liberalization given product variety (including such issues as the possible collapse of specialized local services, "brain drain" concerns, and various regulatory

---

[2] See the discussion of empirical studies in Section 5 for citations.

[3] See Sapir and Winter (1994) for a survey of some of the earlier work on theoretical aspects of service trade.

issues), asymmetric information issues, concerns about quality of services, the effects of services liberalization on the structure of firms, issues specific to network industries, and more general political economy issues. The models in the appendix both provide an introduction to the different approaches in the theoretical literature and are suggestive of how some of the gaps in the theoretical literature can be addressed. I also indicate possible directions for future work.

The final three sections provide a brief review of some of the empirical literature and suggest some policy implications. I then draw a few conclusions.

Conceptual issues

Goods versus services trade

An analysis of the potential benefits and costs of trade or investment liberalization in services requires a conceptual or theoretical framework. That is, we need a model of the economy to highlight the fundamental forces that drive trade and foreign investment, and trace through their effects on various sectors of the economy and ultimately on the real incomes and economic well-being of individuals.

There exists a well-developed body of theoretical and empirical techniques for the study of international trade and investment, but it is fair to say that most presentations of trade theory tend to focus on trade in goods. Much of the analysis of trade liberalization in textbooks focuses on the effects of removing taxes and other impediments that affect the physical movement of goods or capital across borders. However, with some shift in emphasis, standard trade theory provides a framework for analyzing services as well as goods.

To determine whether standard trade theory is useful for analyzing international service trade, we first need to be clear on what a service is, and how it differs from a good. There are many definitions in the literature[4], but the one that I find most

[4] See Hill (1977), Sampson and Snape (1985), and Sapir and Winter (1994).

useful is from Nicolaides (1989). He defines a service as a process; that is, a service is a transaction involving an agreement to perform certain tasks.

With this definition in hand, let us consider whether standard trade theory is equipped to deal with service trade. In standard trade theory, consumers have preferences over bundles of goods and services; and consumption is constrained by prices and income. Consumers can spend their income on either goods or services, or some combination of both. Firms produce products from inputs, and they sell these products either to consumers or to other firms as intermediate goods. Again, there is no presumption that inputs or outputs must be "goods." In fact, in standard trade models, inputs are typically thought of as services from labour, land or capital. Transportation services or insurance can be thought of as intermediate inputs. Plus, although in trade theory we often think of firms' outputs as "goods," there is nothing that requires this. In other words, standard trade theory is simply an application of standard microeconomic theory, and so, at an abstract level, it applies to both goods and services.

In practice, however, applying international trade theory to services requires a shift in emphasis. Some issues in goods trade, such as border taxes, are not relevant in service trade. Also, many issues, such as labour mobility or investment, although they do arise in goods trade, are central to the analysis of service trade. Below, I highlight several ways in which goods trade and service trade may differ.

Intangibility of the product

Since a service is a process, a transaction involving a service need not involve a physical product changing hands. In an international context, this means that a tangible good need not always cross borders for a transaction to occur. On the one hand, this creates opportunities for trade (via telephone, video-conferencing or the Internet) that are free from interference by customs' authorities. However, on the other hand, it also means that the types of barriers that inhibit trade may be different and more complex than those for goods.

Physical presence of client and service provider

For many types of services, the service provider must come into direct contact with either the client or a site owned or operated by the client. As has become standard in the literature, this leads to a classification of four different means of international service transactions:

- The client may come to the service provider.
- The service provider may come to the client.
- The service provider can set up a branch office or service facility in the client's home jurisdiction and service clients from that facility either by hiring local personnel or by using foreign personnel.
- If physical interaction is not required, then the transaction can occur via standard cross-border trade, where interaction occurs via mail, telephone, video-conferencing, Internet, etc.

Haircuts and surgery are examples of cases where the client and service provider must meet. In either of these cases, either the client can come to the service provider, or the service provider can travel to meet the client. Plumbing is an example of a case where the plumber must typically come to a site owned or managed by the client. In each of these cases, the service provider may also be able to service the client via a branch office in the clients' local jurisdiction. International vacations, on the other hand, provide an example of a service where the client must travel to the service provider. Finally, for some types of services, some combination of any or all of these methods of delivery may be involved. For example, a tour guide working in Canada for a British multinational travel company could use the Internet to arrange air transportation from a U.S. airport for a group of clients and then physically escort the group to a vacation destination in Africa, where the tour guide is assisted by local service providers.

The need for physical interaction between the client and service provider is a major way in which some (but not all) service trade differs from goods trade. Goods can be shipped to clients, but services in many cases cannot be. This means that restrictions on labour mobility and investment can provide major impediments to international service transactions.

Because a service is a process, or an agreement to perform certain tasks, it may not be possible to separate a service from the factor inputs (such as labour and capital) that are used to produce it. For example, if I were a plumber and was hired to fix a sink in the United States, then I would have to travel across the border and sell my labour services to my U.S. client. That is, to export plumbing services, I need legal authorization to cross the border and work in the United States. The only way I can export is to sell my labour services directly to a foreign client in the foreign country

If instead I were a woodworker then, similarly, I could travel across the border and sell my woodworking services to a company in the United States that makes wooden tables. However, alternatively, I could use my woodworking skills to build tables in Canada and sell them to customers in the United States. That is (in the absence of legal impediments), I could either sell my labour services directly to a foreign client to produce a good in the foreign country, or I could sell my labour services indirectly by selling the table. We can think of the table as containing "embodied labour services."

One way to think about goods trade liberalization is that it is a way for factors to sell their services to other countries indirectly as factor services embodied in goods. Gains from trade in factor services accrue to both the buyer and seller, but the factor itself need not physically cross borders. This type of trade liberalization has a great deal of appeal to those who are unwilling to allow unrestricted mobility of labour and capital across borders. Countries are able to maintain full control over immigration and foreign investment, but, at the same time, reap at least some of the benefits of trade in factor services by committing to a regime with free trade in goods.

Because many types of services cannot be embodied in a "good," many proposals to liberalize service trade are, in fact, proposals for increased labour mobility or investment across borders. This is a significant departure from the focus of goods trade liberalization and raises a number of issues such as why labour mobility is restricted in the first place, and whether rules

for labour mobility and investment should be different in service industries than in other industries.

Public provision of services

One of the major functions of governments in modern economies is to provide certain services such as education, health care, security, nature parks, and so on. This means that many services are produced or managed by the public sector. Moreover, there has often been a conscious decision to provide these services outside the market. The range of services provided by the public sector varies across countries. It also varies across time within countries in response to the changing priorities of the electorate.

The overlap between market and non-market provision of services raises a number of issues that are less important in the case of goods trade because of a much smaller government presence in the goods sector in market-oriented economies. Should governments be constrained by rules on procurement of services? Should the electorate retain the power to elect a government with a mandate to move a service into the public sector (as, for example, happened in British Columbia with automobile insurance) and, if so, under what terms? Is public provision of a service an unfair subsidy? How do we account for the costs and benefits of an agreement that may constrain governments' flexibility in the public provision of services?

Regulation

Domestic regulations are a more important hindrance to international trade in the service sector than in the goods sector, in large part because services are a process rather than a product.

Goods production is subject to extensive regulations that vary across countries. Health and safety regulations, environmental restrictions, zoning laws, and so on, all affect goods production. However, the problems arising from different types of regulation across countries can be circumvented in an international trade regime, if countries agree that, when goods

cross borders, they retain the right to regulate characteristics of *products*, but not the *process* by which the good is created. That is, for example, countries can impose automobile-emissions standards, but cannot impose rules that require that imported automobiles be produced by workers that are subject to the same labour laws as home workers. This distinction between product and process regulation is not always as clean as I have implied above, but it goes a long way toward smoothing goods trade flows.

A similar option is not available for most services, if we think of a service as a process rather than as a product. Also, since domestic regulations applied to services are process regulations, the application of these regulations to imported services are regulations affecting the process by which the foreign service provider produces services. Since process regulations differ across countries, regulatory conflicts are inevitable.

Heterogeneity of services

Just as there are many different types of goods, so too are there different types of services. Heterogeneity in the fundamental characteristics of either goods or services means that highly stylized models may overlook some important characteristics of some sectors. In such cases, more specialized models are needed. As examples, some services are provided via networks (such as telecommunications and financial services); many are subject to problems of asymmetric information (such as in insurance); and others can affect firms' decisions about whether to produce inputs internally or contract with outside firms. These and other issues call for specialized models.

Because the scope of this paper is limited to a broad overview of the costs and benefits of service trade and investment liberalization, these specialized characteristics of certain types of services will not be addressed here in much detail. However, there is much scope here for future work.

Standard trade theory is well equipped to handle both goods and services. This means that an analysis of the benefits and costs of services trade and investment liberalization does not require a paradigm shift, but it does require a shift in emphasis and a focus on new types of questions. Perhaps the two main reasons why formal trade agreements in the services sector have lagged behind those for goods trade are the importance of both labour mobility and foreign investment as part of service delivery, and the role of domestic regulation as a trade impediment. Both of these issues have been studied in the standard trade literature, but much more work in these areas is needed as the focus of trade liberalization shifts toward services.

Review of the theoretical literature

There are four principle approaches to modelling the effects of services trade liberalization in the theoretical literature.

Some models apply the standard competitive model, where trade is based on comparative advantage. In these models, trade arises because of differences between countries.

Monopolistic competition models explain trade between similar countries on the basis of firm-level scale economies, consumer demand for product variety, and/or firms' demand for specialized intermediate inputs. In contrast to comparative advantage-based theories, these models are not based on inherent differences between countries. Rather, trade arises because firms carve out their market niche and produce distinctive products that are appealing to customers in many different countries. These models predict large volumes of trade between similar countries.

There are also economic geography models, where there are agglomeration incentives. In these models, trading costs can lead to concentrations of economic activity in certain centres. Freer trade lowers some types of trading costs. This sometimes leads to greater concentration of economic activity in the "core," but it can also lead to more dispersion of activity.

Finally, there are models that focus on special issues such as transportation services.

Most of these approaches can be used to investigate the four different modes of service delivery; however, in practice, they tend to focus on either direct trade or foreign investment. In some cases, multinational firms are explicitly modelled in a general equilibrium framework, and, in other cases, investment is modelled as a movement of factors of production across borders. As well, some papers model services as a final consumer "good," while others treat services as an intermediate input, and some do both.

The set of theoretical papers that explicitly set out to model services trade is actually rather small; many of the papers end up looking more as less like an application of standard trade or factor-movement models with one or more of the sectors or inputs defined as a "service." This is not surprising for reasons discussed above. This does suggest, however, that the most fruitful approach for understanding trade in services is likely to make use of the standard trade-theory literature, adapting the models to the special circumstances of the services under consideration, where necessary. The recent work in trade theory investigating endogenous multinational firms and the work on models with transport and communication costs is likely to be fruitful in this regard. I discuss some of this work below.

Comparative advantage models

In a large class of models, trade is driven by differences between countries. Technology, relative factor supplies, and government policy are the main types of differences emphasized in this approach. These differences lead to disparities in relative goods prices and/or factor prices across countries in the absence of trade. That is, relative costs of both inputs and outputs tend to differ across countries, and this creates incentives for mutually beneficial trade. Deardorff (1985), Burgess (1990), Melvin (1989), and Jones and Ruane (1990) all apply this approach to the service sector. As well, services can be treated as being produced either for final consumption or as intermediate inputs. Burgess focuses on

services as intermediate inputs, Melvin and Jones/Ruane focus mainly on final consumption, while Deardorff investigates both. In all cases, it is useful to think of there being pre-existing trade in goods.

Models in which trade is stimulated by differences between countries predict gains from trade from two sources: gains to exporters and gains to consumers of imports. These gains are always potentially available, when prices differ across countries.

Exporters gain from access to a large external market. If, for example, Canada has an abundance of well-trained mining engineers, liberalized service trade would allow Canadian engineering firms to work on projects in foreign countries. This would increase demand for the services of Canadian engineers, and thereby raise their real income. That is, freer trade creates job opportunities and raises income in those sectors of the economy in which a country has a comparative advantage.

Conversely, in other sectors of the economy, consumers benefit from access to lower-priced foreign services. That is, imports expand in those sectors in which Canada has a comparative disadvantage. This places increased competitive pressure on firms in import-competing sectors. However, this is the other source of standard gain from trade: freer trade benefits consumers by increasing competition and providing more choices at lower prices.

Standard comparative advantage models tend to predict that freer trade will increase national income at the aggregate level. That is, the country "as a whole" is predicted to benefit from freer trade. However, these models do not predict that everybody gains from trade. Those who work in import-competing sectors will find themselves subject to increased competitive pressure. Both workers and firms in these sectors can lose during the adjustment to freer trade.

The possibility that some people may lose from trade liberalization means that it may not receive unanimous support. However, it should be noted that a well-functioning economy is continuously subject to many types of changes that require adjustments by firms and workers. For example, changes in technology can also cause workers to lose jobs and firms to go

out of business because of increased competitive pressures. The introduction of new technologies is therefore sometimes subject to resistance as well. However, new technologies also create new opportunities. While governments in modern market economies may restrict new technologies for health and safety reasons, they typically do not block new technology because of concerns that some people may lose their jobs. Freer trade is similar in this respect to the introduction of new technology—it creates new opportunities, it can lower prices and raise aggregate income, but it can also lead to losses in some sectors, raising the usual structural adjustment issues (social safety net, etc.).

Factor-price equalization: Trade in goods and factors as substitutes

If technology is similar across countries, then, in some cases, free trade leads to a convergence of factor prices across countries. This is because, as we noted above, we can think of trade in goods as embodied trade in factors. Labour in one country competes with labour in another country indirectly via competition in the markets for goods that labour produces. This increased indirect competition between workers in different countries tends to reduce the wage differentials that caused the trade in the first place.

This can have important implications for the effects of liberalizing service trade in a world where we already have relatively free trade in goods. Free trade in goods alone may already have led to substantial convergence of factor prices, and may thereby already have reduced some of the potential differences across countries.

Suppose that, initially, services are not traded, but that services use the same types of inputs as goods, and that technology is the same across countries. If free trade in goods equalizes factor prices across countries, then, even though services are not traded between countries at all, the prices of services may be equalized across countries via the general equilibrium consequences of goods trade. This can happen in the Burgess model but also in many other models, where there

are at least as many traded goods as factors. The basic idea is that trade in goods is really an indirect way of trading factor services, and, in some cases, trade in goods alone is sufficient to allow all of the potential gains from factor service trade to be realized.

Therefore, one important implication of models where trade is driven by differences is that trade in goods alone, without any service trade, can reduce the economically relevant differences across countries, and therefore can reduce the potential benefits of service trade. In the extreme case of full factor price equalization, trade in goods alone can completely eliminate the potential additional gains from service trade liberalization. As an example, suppose that trade in goods equalizes wages across countries. Then, even though janitorial services are not traded internationally, wages of janitors will be equalized via competition in the internal labour market of each country, and thus the price of janitorial services will also be equalized. Liberalizing trade in janitorial services in this model would yield no benefits, if there is pre-existing trade in goods. Notice that this does not imply that services trade liberalization will cause any harm; it is just that it need not yield any benefits.

Factor prices not fully equalized by trade in goods

Of course, trade in goods alone will not always equalize factor prices and non-traded services prices. For example, if there are inputs used in the services sector that are not used in the goods sector, then trade in goods alone does not provide a channel for indirect trade in these factor services. As well, differences in technology, domestic policy, and other attributes of the production structure of economies, can prevent full factor price equalization. In these cases, liberalizing trade in services will generate standard gains from trade to both exporters and consumers as discussed above.

Services trade and factor trade as substitutes

One of the major issues in services trade is whether it makes a difference if one liberalizes direct trade in services, or whether

trade via the other three modes of supply is also liberalized. Two of the other modes involve movements of inputs (labour or capital) between countries.

Mundell (1957) pointed out that, in some cases, trade in inputs and outputs are perfect substitutes for each other, and so it does not really matter which liberalization route is chosen from a welfare perspective. In these cases, the gains from trade due to differences in services prices across countries can be realized by either trading the services directly, or by allowing the factors that produce the services to move. This is important for services, because, in many cases, direct trade in services is not feasible, because buyers and sellers have to meet. In these cases, allowing factor movements such as direct foreign investment, can allow countries to reap the potential gains from trade.

Goods trade and factor or service trade as complements

Once we allow for differences in technology across countries and richer detail in the production structures within countries then, even in the standard competitive trade model, trade in outputs and trade in factor services may be either substitutes or complements, as demonstrated by Markusen (1983). Markusen and Svensson (1985) show that, with differences in product-augmenting technology, allowing factor mobility will tend to magnify the volume of trade between countries. This result has important implications for trade liberalization, because it implies that allowing free trade in factors can strengthen the gains from goods trade.

Similarly, if we think of services as intermediate inputs, then trade in services and goods can be complementary. Burgess (1990) treats services as intermediate inputs and finds that service trade can stimulate goods trade, when there are technological differences across countries. Moreover, in these models, services trade has the potential to have quite significant impacts on welfare. Suppose a particular service is an essential input. Then, without access to efficient provision of this service, a country may not be able to produce at all. As an extreme example, suppose a country has oil fields, but does not have the

expertise to drill and extract the oil. By allowing imports of oil-extraction services, a country can potentially generate huge amounts of wealth for itself. That is, for some types of services, trade liberalization can leverage or catalyze potentially large gains in other sectors. Deardorff (2000) shows how this type of complementarity can be particularly important, when transportation services are needed to facilitate trade in goods. Freer trade in transportation services lowers shipping costs and increases gains from goods trade.

These issues are not confined to the services sector: similar types of complementarities can also occur in the case of goods trade. Allowing imports of some types of intermediate goods may boost productivity and increase trade in other goods sectors. For example, energy imports can lead to a significant increase in overall productivity and boost overall trade in goods. The more general point is that allowing trade in intermediate goods or services can boost production efficiency in both the goods and services sectors of the economy.

Income distribution and complementarities

Complementarities between services trade and domestic production have important implications for income distribution. If we view domestic and foreign factor services as substitutes for each other, then allowing foreign factors of production access to local markets can reduce the demand for local factors, lower their income and generate political opposition to trade liberalization.

If, on the other hand, domestic and foreign factors are complements, then liberalizing restrictions on foreign workers and capital can stimulate domestic employment. This can be particularly important in cases where team production is important. For example, in large engineering projects, access to foreign expertise can increase overall productivity and create demand for local engineers. Access to a foreign movie star may make a local movie production more marketable and increase demand for local actors. This suggests that liberalizing restrictions on factor movements for factors that generate complementarities within the same class of factor can not only

increase production efficiency, but can also find political support among factors in the same sector.

Liberalizing trade in services versus allowing factor service mobility

Some papers using the competitive trade model considered the choice between liberalizing trade in services and allowing factors to move across countries, perhaps temporarily. Once we move beyond the very simple trade models with identical technology, these two options are no longer equivalent. [5]

Jones and Ruane (1990) considered this issue in a simple trade model, and their main conclusion was that the income distributional effects differed depending on the type of liberalization. In their model, domestic and foreign factors of production are substitutes, and so the complementarities in the factor market noted above do not arise. As a simple example of their approach, consider a case where a country has superior technology in computers and so has a comparative advantage in computer technology. Then factors specific to the computer industry will earn high returns. Freeing trade in computers will lead to exports, which increases the income of the computer industry-specific factors at home. However, if, instead, factor service trade was liberalized, then, because of the high return to computer-specific human capital at home, the home county would attract computer workers from other countries, pushing down the real return to local computer workers. That is, although both options will increase the country's overall real income, the distribution of income will be very different. The pattern of political support for liberalization will therefore vary with the types of liberalization proposed. Those who support freer direct trade in services will not necessarily support freer movement of personnel.

[5] It should be noted, though, that a small country will find it optimal to simply allow both free trade and free factor mobility.

So far, I have focused only on how trade liberalization can affect a country, when the fundamental forces driving trade or investment have their roots in differences between countries. Differences between countries, are, however, only one of the major forces that drive trade and investment. In fact, much of the world's trade occurs between high-income countries, suggesting that similarities across countries do not deter and may even expand trade. There are several explanations for trade between similar countries, all of which are highly relevant for the services sector. Most of these explanations involve scale economies at either the firm or the industry level.

Melvin (1969), Markusen and Melvin (1981), Ethier (1982a), and others demonstrated how incentives to specialize arising from scale economies can generate trade between similar countries. Trade in this approach is not driven by comparative advantage; in fact, there need not be any comparative advantage at all for trade to occur. Instead, trade *creates* differences between countries, as firms in a given industry tend to agglomerate in one country to take advantage of external economies of scale. If trade equalizes factor prices across countries, then all countries benefit from the increased productivity arising from agglomeration. However, if the agglomeration effects are extreme, it is also possible that trade may lead to the contraction of some industries in some countries. This reduces productivity and can lead to losses from trade. This result would occur if there were extreme specialization, such as the world's production of a good or service being concentrated in a few locations. Services industries subject to powerful agglomeration pressures include film production and some financial and investment services that are concentrated in a few major world centres. However, this is not a feature of many (if not most) services whose production tends to be widely dispersed, even within a single country.

An alternative approach is to suppose that specialization occurs at the firm level, and that there is a taste for a variety of services in any given service category. This approach was introduced by Krugman (1979, 1980) and was developed more

fully in Helpman and Krugman (1985). Consumers either individually or collectively desire a variety of goods and services within various categories, such as restaurants, forms of entertainment, architectural designs, and so forth. Firms respond by carving out a market niche for themselves to produce specialized products. If there are fixed costs, firms with access to larger markets will have lower average costs, so trade can create productivity benefits even without comparative advantage, as in the papers discussed above. As well, opening up to trade will allow consumers in the home country access to a wider variety of specialized products, since they have access to foreign as well as home varieties.

Ethier (1982b) pointed out that firms also benefit from having access to a wide variety of specialized intermediate inputs and adapted the Krugman model to show how gains from trade can arise from trade in intermediate goods between similar countries.

Building on Ethier's work, Markusen (1989) developed an influential model of trade in producer services. Producer services are services such as banking, consulting, engineering, etc., that firms use as inputs to produce other goods or services. In Markusen's model, firms use services as intermediate inputs, and the cost of production falls, as they gain access to a wider variety of producer services. If no trade in either goods or services is possible, then production of final goods is cheaper in larger markets, because a larger market can support a greater variety of services. Markusen then compares the effects of liberalizing trade in the goods sector versus doing the same in the services sector. If trade in only final goods is possible, then goods production tends to agglomerate in the larger country. The large country clearly gains from this as productivity improves, since a larger final goods sector can support a wider variety of intermediate goods production. However, if full agglomeration does not occur (because of rising labour costs in the large country), then the smaller country can lose from goods trade, because the decline of final goods production leads to a shrinkage of the producer service sector, which, in turn, induces a reduction in productivity. Productivity losses drive down wages and possibly can lead to welfare losses from trade. With

trade in final goods, the model behaves much like the external economies of scale model of Markusen and Melvin (1981).

Suppose, instead, that there is free trade in services, but not in final goods. Then, as a result of trade, all countries, even small ones, have access to the full range of producer services. As a result, productivity in final goods production increases in all countries, and so all countries must gain from trade. An important feature of this analysis is that domestic and foreign services are complements; that is, trade allows access to different types of services that were unavailable previously. These services, even if they are cheaper, do not crowd out the demand for local services, but rather are used in combination with them to render final goods production more efficient than prior to trade. One of the major implications of this approach is that smaller markets especially may have a strong interest in liberalizing trade in producer services, since this can partly offset the incentives for firms to locate in larger markets.

Van Marrewijk et al. (1997) extend Markusen's model to allow for both factor abundance differences across countries, as well as differentiation of producer services as a motive for trade. They also allow service providers to sell services either directly or by setting up a branch plant in a foreign market. Earlier models, such as the Heckscher-Ohlin model, the Krugman model or Markusen's model, can be obtained as special cases. This approach is potentially a useful way to study interactions between the different motives for trade; however, conclusions about the benefits and possible costs of trade are much the same as in earlier work.

Francois (1990) takes a somewhat different approach to producer services in a differentiated products model—he assumes that firms are more productive if they can break down the production process into smaller activities. However, producer services are needed to coordinate these activities. If trade reduces the costs of producer services, it allows greater specialization of production. This idea that producer services may help to determine the equilibrium structure of the firm is also discussed by Jones and Kierzkowski (1990) somewhat informally, and also by Deardorff (2000), who points out that trade-induced reductions in costs of transportation,

communication, insurance, etc. can encourage a firm to "fragment" its production across different countries to exploit the comparative advantages of different countries in different aspects of the firm's production.

Foreign direct investment

Since foreign direct investment is one of the major ways in which services are provided across borders, an investigation of the implications of liberalizing services trade requires a general equilibrium model with multinational firms. Although this adds considerable complexity to standard trade models, much progress has been made in recent years.

Helpman (1984) and Markusen (1984) produced two of the seminal papers in the general equilibrium modelling of multinational firms. Helpman focused on models of vertical multinationals. In his model, a firm with a head office in a capital-abundant country might locate its production activities in a labour-abundant country to take advantage of differences in labour costs. Markusen's approach focused on horizontal investment. If exporting to a foreign country is costly due to transportation costs or trade barriers, then firms can instead choose to set up a branch plant in that country to produce for the local market there. Although both of these approaches have some implications for services trade, Markusen's market access approach is probably the most relevant for most types of services. As noted earlier, many services are non-tradable directly for technical or regulatory reasons; accordingly, setting up a local presence to obtain local market access is one of the major modes of supply.

Brainard (1993) developed a simple model in which firms trade off the fixed costs of setting up a branch office in the foreign country against incurring the trading costs from exporting. She relied on a great deal of symmetry for her results, but finds that multinationals are more likely to be the chosen model of supply, when trading costs are high and the fixed costs of setting up a branch plant are relatively low.

Markusen and Venables (1998) study the endogenous creation of multinational firms, using a general equilibrium

model in which both comparative advantage and market access provide motives for trade. They focus on the market access motive[6] for creation of multinationals, and show how transport costs endogenously determine the mode of supply.[7] They do not consider the role of product differentiation, but consider a model with two homogeneous goods. One sector is competitive, but the other is organized as a duopoly.[8] Trade or foreign investment does not increase product variety in this approach, but rather can reduce prices by increasing market size. As is standard in this approach, barriers to trade make the emergence of multinational firms more likely.

The main results of this model centre on the role of asymmetries across countries in determining the emergence of multinationals. In particular, large differences between countries make multinationals less likely to emerge. This derives from the fact that differences in factor endowments

---

[6] Markusen et al. (1996) generalize this approach to allow for both vertical and horizontal multinationals. They obtain similar results regarding horizontal multinationals, but there is added richness to the model, since firms have the added option of fragmenting their production across countries to exploit the different comparative advantages. Vertical multinationals are more likely to emerge when countries have very different factor endowments; horizontal multinationals are more likely when countries are similar. High transport costs increase the likelihood of horizontal multinationals. Vertical multinationals, on the other hand, are set up to export back to the home market and thus require relatively low transport costs. Because of the second-best nature of the model, allowing the creation of multinational firms does not always lead to an increase in welfare.

[7] One could also interpret "transport costs" more broadly to encompass other factors, including communication difficulties or regulations that act as barriers to direct trade in services or goods across borders.

[8] In this model, the duopoly (a market with two producers) emerges, despite the absence of restrictions on entry, because the industry faces high fixed costs of production. Each firm in the duopoly is assumed to observe the other passively, and to take its production and pricing decisions as given, then it makes its own decision to maximize its own profits. The resulting equilibrium is known as the *Cournot equilibrium*. Other equilibria are possible in a duopoly, if the firms adopt active strategies; these are described in game theory. Different behaviour by the duopolists could affect the theoretical conclusions reached concerning the implications of trade liberalization.

across countries tend to concentrate production according to comparative advantage and thus reduce the benefits of multinational production. Differences in size across countries also reduce the incidence of multinationals because of the fixed cost of setting up branch plants: it is harder to recover fixed costs in small markets. Markusen and Venables also find, however, that relatively smaller countries always gain from the creation of multinationals, whereas large countries may possibly lose. This is because large markets always have an advantage when there are large fixed costs, but the possibility of multinational production tends to reduce the advantage of being in a larger market.

Markusen, Rutherford and Tarr (2000) extend the Markusen (1989) model of producer services to allow for foreign multinationals. They consider a small country producing both final goods and producer services; skilled labour is employed intensively in both goods and services production. Foreign multinationals also produce local services, using local inputs combined with some imported factor (e.g. foreign workers). Local and foreign services are imperfect substitutes for each other. Local service providers are assumed to be unable to export or to create multinationals—the focus of the paper is on the implications of liberalizing restrictions on service trade for developing countries.

As one would expect from Markusen (1989), he finds that access to imported inputs, which allow foreign multinationals to produce local producer services, increases productivity in the goods sector, generating large aggregate gains for the economy. This result occurs because, even though foreigners are competing with local skilled workers in the services sector, the productivity boost to the goods industry from allowing foreigners to have market access in producer services stimulates the production of goods enough to increase the overall demand for domestic skilled workers. That is, a scale effect offsets a substitution effect. Consequently, domestic and imported foreign services can be *general-equilibrium complements*, even though they are *partial-equilibrium substitutes*. Another interesting result is that allowing access to foreign service providers can alter the pattern of goods trade. That is, the

increased efficiency in goods production arising from access to foreign suppliers of producer services can be large enough to induce the country to start exporting some goods that previously were imported.

Models with agglomeration

Economic geography models, which have their roots in the product-differentiation models of Krugman (1980) and Ethier (1982b), are used to study the implications of trading costs and factor mobility for the location of economic activity.[9] Some of these models have important implications for services trade; here I will discuss two examples of this approach to give an indication of its potential.

Krugman and Venables (1995) consider a model where both consumers and firms care about product variety in what I will interpret as a service sector. Firms in one sector (X) of the economy use producer services, and consumers demand these same services as part of their consumption. This paper is noteworthy, because it shows how a "core" and a "periphery" can develop, even if factors cannot move.[10]

To understand this, suppose two countries are initially identical, and trading costs are very high. Then there is very little trade, and both countries have essentially identical outcomes. However, as trading costs fall, firms in sector X face two opposing pressures. On the one hand, there is pressure to be near consumers to avoid trading costs in selling to consumers. On the other hand, there is pressure for X producers to be near their preferred supplier of the differentiated producer services to reduce production costs. At some point, as trading costs fall, the incentives to be near suppliers wins out, and firms in the X sector tend to agglomerate in one country. This becomes self-reinforcing—a larger X sector increases local demand for

[9] For a good overview, see Fujita, Krugman and Venables (1999).

[10] Core-periphery models were introduced into economics literature to explain the sharp territorial contrasts in the level of economic development and intensity of industrialization in the economic heartlands (the "core") versus surrounding areas (the "periphery").

producer services, which lowers costs even more and attracts even more X producers. Because of transport costs, consumers stuck in the periphery are worse off than in the core and may be worse off than before trade occurred.

This model illustrates that, in some cases, limited trade liberalization can hurt a country. However, as trade liberalization proceeds, eventually it becomes cost-effective for firms to purchase services from firms in the periphery because of lower costs. Once trade is fully liberalized, the distinction between core and periphery disappears, and both countries are better off than without trade. This model is highly stylized, but it does raise the possibility that piecemeal trade liberalization can have unanticipated side effects. In this model, allowing various different modes of access (such as foreign investment) could reduce the disadvantage of being in the periphery. This latter point is also the theme of the Markusen, Rutherford and Tarr (2000) paper discussed above.

Markusen and Venables (2000) have made perhaps the most ambitious attempt to fully integrate all the major approaches that have been discussed above. They integrate the Helpman/Krugman model of intra-industry trade based on product differentiation with a theory of endogenous multinational corporations. As well, they discuss the potential for agglomeration, if factors can move. Comparative advantage in this model is determined by the interaction between country size and relative factor abundance. They find that multinationals are likely to emerge when countries are similar and transport costs are high, in order to obtain access to foreign markets. Although it is not the focus of the paper, they point out that, in their model, smaller markets tend to gain from allowing multinationals, but that larger markets may lose. Multinationals increase access to foreign goods and services that would not otherwise be available in a small market.

Markusen and Venables also investigate the implications of allowing factor mobility. When transport and other trading costs are low, and all factors are mobile, there is a tendency for all factors to agglomerate in one country. If only capital is mobile, there is a tendency for partial agglomeration. If capital/labour ratios and market size are similar across countries, movement of

capital to one country shifts some producer service production to that country, increasing product variety and lowering prices of producer services there. This increases real income of capital in that country, which encourages still more capital movement. At some point, though, so much capital has flowed in that local competition pushes down its nominal return enough to counterbalance the benefits of greater product variety and lower prices of producer services. A stable equilibrium is then attained. This agglomeration result for capital only holds when transport and other trading costs are low, suggesting that liberalizing services trade without liberalizing market access via multinationals or movement of persons could increase the tendency for agglomeration of factors specific to service industries.

Finally, they show that allowing multinationals reduces the tendency for agglomeration—it increases the demand for capital in smaller countries, pushing up its return and reducing the factor price differential with the large country.

Dynamic gains from trade and investment

Up to this point, I have focused on static models. These models capture the costs and benefits of trade at a given point of time, but do not address the way in which trade can influence the evolution of an economy over time through its effects on incentives to innovate, and to invest in physical and human capital.

The theoretical literature on the interaction between trade, innovation and growth is most extensively investigated by Grossman and Helpman (1991).[11] The key idea in these models is that, when an economy opens up to trade, the opportunities to export to larger global markets creates incentives for firms and individuals to invest in innovative activity. As well, increased pressure from importers can also stimulate firms to become more innovative to stay competitive. In most cases, introducing dynamics into the standard models of trade tends to magnify the

[11] Baldwin (1992) and Taylor (1994) are also important references on the dynamic gains from trade.

standard gains from trade because of the added boost from investment and innovation.[12] These models tend to focus on goods trade, but similar forces would be expected to apply to the service sector as well, since many services such as telecommunications, software and transport are innovation-intensive. While economists have long believed that the dynamic gains from trade are likely much more significant than static gains, this remains an active area of research in the empirical literature. Rodriguez and Rodrik (1999) provide a critical survey of some of the influential work in this area, suggesting that it is very difficult to quantify the effects of trade on growth, while Srinivasan and Bhagwati (1999) look at the same work and argue that the evidence that trade stimulates growth is persuasive. In the Canadian context, Trefler (1999) has evidence that suggests that the NAFTA stimulated process innovation in Canada, but not product innovation. All of these issues are important to consider when assessing the magnitude of the gains from services trade, but they are also difficult to measure.

As well, there are models of investment in human capital in which individuals base their decisions to invest in job training and education on the opportunities in the economy.[13] Freer trade creates increased opportunities to use skills in those sectors in which the country has a comparative advantage; or it creates incentive for firms and individuals to invest in skills that allow them to carve out a market niche to service both local and foreign markets. If Canada has a comparative advantage in knowledge-intensive industries, these models would predict that freer trade would increase the incentives to invest in human capital, so that dynamic gains from trade would be greater than the static gains.

---

[12] These models do not rule out the possibility that trade may decrease growth. As Young (1991) points out, if a country has a comparative advantage in sectors that are not innovation-intensive, then freer trade can cause an economy to shift resources out of innovation.

[13] For example, see Findlay and Kierzkowski (1983) and Das (2001).

Finally, in some types of service sector industries (such as air travel within Canada), there are only a very small number of firms that interact with each other strategically. In these cases, one of the major potential benefits of trade liberalization is that it can erode market power and render firms more competitive. This benefits consumers and other producers who use these services as intermediate inputs. Potentially offsetting these benefits, however, is that limited entry by foreign firms into domestic markets like this may shift profits from domestic to foreign firms[14], and possibly shift rents from factors employed in those firms to foreigners. The concerns raised by this caveat are somewhat mitigated, however, if ownership of both domestic and foreign firms is diversely held across countries—Canadians can hold stock in U.S. firms with market power and U.S. citizens can hold stock in Canadian firms with market power. There is a large literature on market power in trade models, but little that specifically addresses special issues relating to services. A full analysis of market power would require some attention to the special features of the particular markets in question. However, there is a strong presumption that trade liberalization in markets that are not very competitive would be welfare-improving.

Summary and gaps in the literature

The theoretical literature that studies the gains from trade liberalization in services is rooted in the standard trade-theory literature. The benefits of trade liberalization come from the usual sources: comparative advantage, product differentiation, economies of scale, increased competition, and increased incentives for innovation and investment.

One of the special aspects of services trade that has been identified is the important role of producer services. Liberalization of trade in producer services can have important effects on an economy's productivity. As well, trade or

[14] How this occurs is shown in Brander and Spencer (1984).

investment in producer services can be complementary to other types of trade and investment in both the goods and services sectors. Finally, while domestic and foreign producer services may be partial equilibrium substitutes, they can be general equilibrium complements. The latter result indicates that, once the full effects of liberalization of trade and investment in producer services are considered, widespread political support may be available.

Another theme of the literature is, however, that services trade liberalization will typically take place in a "second-best" environment in the presence of distortions and market failure. Accordingly, there is no guarantee that trade or investment liberalization is always welfare-improving. This underscores the need for much more analysis of models that address these issues, at both a conceptual and empirical level.[15]

There are still a few important gaps in the literature. First, while there has been considerable progress in integrating the theory of multinational firms into general equilibrium models of trade and investment, this work is still relatively new. More work needs to be done, particularly in the analysis of the effects of different types of trade and investment policies in such models. As well, there has been relatively little study of two of the four modes of service supply: movement of personnel across countries and movement of customers across countries. There is no model that allows for endogenous interaction between all four modes of supply.

Second, many models tend to focus on only one service sector. Given that trade liberalization in services will proceed on a piecemeal basis, with some sectors being liberalized more than others, it is important to consider the potential cross-sectoral spillover effects of such liberalization.

Third, much of the analysis of the effects of relaxing rules on mobility of factors across countries has not done so in a

[15] Some of the features that lead to departures from optimal economic outcomes include (a) product differentiation that gives firms some market power, so that price is above marginal cost; (b) market size effects that introduce non-convexities and/or externalities; and (c) agglomeration forces that can lead to multiple equilibria. Models dealing with these issues can be quite complicated.

model that captures the reasons why governments limit factor mobility in the first place. Why should skilled workers be allowed to move across borders to provide services and not unskilled workers? If service providers can move across borders to perform services, why not workers in industries producing goods? These questions really have not been fully addressed in the existing models.

Finally, a major gap in much of the literature is the role of regulation. Despite some of the caveats noted above, there is a strong presumption that trade and investment liberalization in services would be beneficial, provided that governments are able to maintain the flexibility to efficiently carry out their regulatory and redistributive functions. However, perhaps the most critical issue in services trade liberalization is how to reconcile different national regulatory regimes with a non-discriminatory free-trade regime. Analysis of this requires a model with both endogenous trade and investment in services, but also with a motive for regulation and endogenous choice of regulations by governments. Much more work is required along these lines, and, in my view, this is the major weakness in the current literature.

Gains and losses from liberalization

In this section, I discuss the implications of economic theory for the benefits and costs of services trade liberalization. The theoretical framework is that of the standard competitive trade model. As necessary, I introduce differentiated products, additional services sectors, trading and transport costs, and government regulation of service provision in the context of positive and negative externalities to highlight specific issues. Pre-existing free trade in goods is assumed throughout. The emphasis will be on issues not discussed in the preceding literature review. In the appendix, the welfare effects of allowing an increase in service trade in one sector are decomposed into various effects. These are discussed below.

If markets are perfect, and countries differ, then if goods trade alone does not fully equalize the prices of services and factors across countries, there are unexploited gains from trade that are available due to standard comparative advantage. These gains can be realized by allowing services and/or factors to be traded. Since many services are costly to trade directly, one of the main implications of this line of work is that potential gains from trade in services can be realized by allowing the factor services themselves to be traded (that is, via trade in disembodied factor services). In a model without any distortions, such trade will always increase global efficiency; moreover, for a small country, unilaterally allowing such trade in factor services will always increase welfare.

It is important to note, however, that there is nothing really special about services here. That is, the same issues arise in the goods sector:

- Free trade in goods need not fully equalize factor prices, meaning that there may be potential for further gains from trade if we allow factors to be traded as well.
- Direct goods trade and factor movements have potentially different effects on income distribution, as, for example, discussed in Jones and Ruane (1990).
- Embodied factor service trade as an alternative to direct goods trade is not always possible (e.g. because of transportation costs).
- The right to establish enterprises in foreign countries to produce goods is not always allowed.

However, more importance is attached to the movement of factors in the services trade literature, because, in some cases, there is no possibility of embodied factor service trade at all.

This raises the question of whether agreements that allow movement of factors should be confined to factors that are specific to the services sector, or whether these agreements should simply apply to certain classes of factors, regardless of which sector they are employed in. It is difficult to address this issue without explicitly modelling why countries have been reluctant to open their borders to full factor mobility. Some of

the recent political economy literature touches on these issues, (see Persson and Tabellini (1999) for a survey) and some recent work on migration models assimilation costs (Konya, 2000), but there is much potential for more work along these lines.

Terms of trade effects in the goods market

Once we move beyond the small country case, standard competitive models predict that, with pre-existing trade in goods, some countries may lose from an agreement to liberalize service trade or investment, even though it increases global efficiency. This result appears in the capital mobility literature[16], and is pointed out explicitly for the case of services trade by Burgess (1990).

The issue here is that liberalizing trade in services affects factor prices. This spills over into goods markets, and affects both the demand and supply for goods. Since goods are already traded, any change in goods prices is a terms-of-trade deterioration for at least one country. These terms-of-trade effects in goods markets have to be weighed against the direct gains from trade in the services sector. In general, either effect can dominate. A recent study by McKibben et al. (1999) using a computable general equilibrium model found that Japan would lose from an international agreement to allow free trade in carbon-emission permits ("environmental services"), starting from a situation of free trade in goods, because of terms-of-trade losses in the goods market. In the context of services trade, Brown, Deardorff and Stern (1996) find that Canada's terms of trade deteriorate from multilateral liberalization in services, and Dee and Hanslow (2000) find that the terms-of-trade loss for Canada is large enough to more than offset the other benefits of liberalization. These studies will be discussed in more detail later in the paper, when I review some empirical studies. At this point, I simply note that concerns about terms-

[16] See Markusen and Melvin (1979), Brecher and Choudri (1982), and Grossman (1984) for discussions of the welfare effects of capital mobility given pre-existing goods trade. Copeland and Taylor (2000) find similarly that allowing free international trade in pollution permits need not benefit all countries if there is pre-existing goods trade.

of-trade effects caused by the opening of new markets are not an idle theoretical curiosity.

From the perspective of a relatively small country like Canada, this is simply a cautionary note; it is not an argument to avoid service trade liberalization. Even if a multilateral agreement on services did result in a terms-of-trade deterioration in the goods market, this would be caused mainly by the effects on world prices induced by liberalization of services by our trading partners. There is nothing that Canada could do about this. Moreover, opting out of an agreement on services would simply make the situation worse, since the direct gains from services trade liberalization would be forgone, leaving only the terms-of-trade effects. Of course, whether the terms of trade in the goods market improve or decline is a complicated matter. If service trade liberalization stimulated demand for resource-based products, then Canada would gain via the terms-of-trade effect in the goods market, and the direct gains from service trade liberalization would be magnified.

Piecemeal reform

Services trade liberalization is likely to proceed on a sectoral basis. Because trade barriers in the services sector cannot easily be converted to tariff equivalents, there is no simple rule such as uniform tariff reductions that can be applied to liberalize all service sectors simultaneously.

It is well-known that piecemeal trade liberalization in the goods sector need not be welfare-improving.[17] That is, suppose that a small country has perfect markets, except that there are various tariffs in place restricting trade. Then, because the economy is small and markets are perfect, the best policy for this country is free trade (that is, zero tariffs on all goods). However, suppose political constraints prevent some tariffs from being removed in the foreseeable future. Then one might think that it is efficient for the economy to get rid of as many tariffs as possible, since that would move us closer to free trade.

---

[17] A good discussion of this result in the trade context appears in Vousden (1990).

However, this is not true in general. This is an implication of the theory of the second best (Lipsey and Lancaster, 1958). That is, arbitrarily picking some tariffs and reducing them, while not reducing other tariffs, has no guarantee of benefiting the economy, and may actually make things worse by exacerbating pre-existing tariff distortions.

In the goods context, there are three ways around this result. One is to use computable general equilibrium models to try to determine whether a given tariff reform is welfare-improving. There should always exist some package of reforms that improve welfare, but an empirical study may be needed to determine what that package's contents should be. Second, one can try to implement gradual, but uniform, tariff reductions, since these can be shown to be welfare-improving in standard trade models. This approach can be used to justify the gradual, but comprehensive, tariff reductions that have characterized multilateral trade liberalization under the GATT/WTO. Third, one can treat the costly spillover effects of piecemeal tariff reductions as simply part of the adjustment costs to long-run free trade. That is, although given tariff reductions may not raise welfare, if they are part of a long-run political process that leads to substantially free trade, then we expect a welfare improvement in the long run, even though the path may be slightly bumpy.

The implications of piecemeal reform in the services sector are somewhat different from the standard analysis of piecemeal tariff reform for a couple of reasons. First, most trade barriers in the services sector are not tariffs, but instead are either restrictions on market access or costs of complying with regulations. Second, although full tariff elimination in the goods sector may seem like an attainable goal, there is not a similar obvious "end target" in services trade liberalization, since many trade barriers arise from qualitative regulations, and thus piecemeal liberalization in the services sector is likely to remain piecemeal for quite some time.

We can model the market access restriction as a quota on foreign access to the domestic market, and the costs of complying with domestic regulations as a real resource cost of

importing.[18] Suppose we have initially free trade in goods, and two service sectors with restricted trade. Call these service sectors Lawyers and Accountants. Suppose we increase market access for foreign accountants but not foreign lawyers. Then there will always be the standard direct gains from trade due to reduced consumption and production distortions in the accounting sector. However, this has to be weighed against possible spillover effects on the legal sector.

It turns out that, in contrast to the case of tariff liberalization, there are two cases where piecemeal liberalization in the service sector can (in theory) guarantee a welfare improvement; but there is also another important case where piecemeal liberalization may not be beneficial.

First, suppose that the only restriction on foreign market access in the legal sector is the real resource costs of complying with domestic regulations to gain access to the local market. Then the domestic price will be equal to the foreign price plus the "red tape" costs. So no rents are collected by importers due to trade barriers in this sector, and the domestic price is tied to the foreign price. Consequently, although trade liberalization in the rest of the economy may affect the volume of imports in other protected service sectors, there will be no effect on the domestic price in these sectors, and there are no rents to be dissipated. Piecemeal liberalization in services must increase domestic welfare in this case.

Next, suppose that there are binding restrictions on market access over and above any red-tape costs. This means that the domestic price of services is above the foreign price, so rents are generated by importing. If all of these rents accrue to domestic residents, then using Falvey's (1988) results, we can conclude that piecemeal liberalization must improve domestic welfare. The reason for this is that the binding restriction on the volume of trade prevents liberalization in other sectors from shrinking trade volumes in other protected sectors. As well, although the domestic price of services in protected sectors may change, this is all internalized by domestic agents, if they

[18] See the appendix for details. One could do a similar analysis for export restrictions.

receive all of the implicit quota rents. Harmful spillover effects of liberalization are therefore avoided.

When can we expect this scenario to be relevant? In the case of goods, this scenario arises if import licences are given to local citizens, so that they collect any benefits (rents) from holding such a licence. However, in the case of services, import licences are not a very realistic scenario. The allocation of quota (or market access) rents depends on whether the local consumer buys the foreign-provided service at the domestic price or at the foreign price. This will depend on the mode of provision of the service. If domestic consumers have to go to the foreign market, they pay the foreign price. If they import the service directly from foreign providers and are free to choose among foreign providers, then competition should ensure that they pay the foreign price. If there is some restriction that limits domestic access to foreign service providers via these channels, then that restriction should push up the domestic price above the foreign price, and those local agents who gain access to foreign providers will collect rents. In scenarios such as this, Falvey's results apply, and piecemeal liberalization will improve domestic welfare.

A more likely scenario, however, is that market access restrictions mainly apply to cases where the foreign service provider either comes to the domestic market directly, or sets up a domestic establishment. In either of these cases, we expect the foreign provider to receive the domestic price for services. If market access is restricted, then the domestic price is likely to be above the foreign price, and thus rents are collected by foreign service providers. In this scenario, Falvey's results do not apply, and liberalization in some service sectors can have adverse spillover effects into other protected service sectors and cause a welfare loss.

To see how this can happen, suppose that allowing increased market access for foreign accountants leads to an increased domestic demand for lawyers, and pushes up their wages. Then those foreign lawyers who do have access to the local market will see an increase in the rents they collect from their privileged access to the local market. This increase in rents acts much like a terms-of-trade loss for Canadians (since the

price of a service we are importing—legal services—rises). If this effect dominates the direct gains from trade in liberalization in the accounting sector, then we experience a net loss.

To summarize, the likelihood that trade and investment liberalization in the services sector will proceed on a piecemeal basis has some important implications for the overall benefits and costs of liberalization. When reform occurs on a sectoral basis, there can be a tendency to focus on the benefits of reform in that sector alone. However, as discussed above, a general equilibrium approach forces us to consider possible adverse or beneficial spillover effects into other parts of the economy. With tariff barriers to trade, these spillover effects, if adverse, can be large enough to overwhelm the direct benefits of trade liberalization.

Whether the spillover effects of piecemeal reform are a serious cause for concern depends in part on the nature of the trade barriers. If trade barriers in services mainly take the form of "red tape" costs of market access, or if market access is restricted but domestic consumers get to buy at the foreign price, then there are no adverse spillover effects from piecemeal liberalization, and focusing on the direct benefits or costs of liberalization in the affected sector can be sufficient to determine the welfare effects of a reform. However, if protection takes the form of market access restrictions that give a limited number of foreigners the right to charge the higher local price, then gains from piecemeal reform cannot be guaranteed, since reform in one sector can raise scarcity rents to foreigners in other sectors. This possible drag on the benefits of service liberalization can be avoided by targeting sectors with such market access restrictions for early reform.[19]

Product differentiation

For many types of services, the major benefit of international trade and investment liberalization is likely to be increased

[19] One could also avoid losses by taxing the rents from foreign service providers in such sectors. However, this is likely to invite retaliation against domestic service providers in other sectors who have access to foreign markets and may be collecting rents there.

access to a wider variety of services. This provides benefits to consumers in two ways. First, there are the benefits from services targeted directly to consumers. Second, there are indirect benefits to consumers, since access to a wider variety of more specialized producer services can lower the costs of both goods and service production. As well, there are benefits to local service providers, as they gain access to foreign markets. Many services require an up-front investment in training, research and development, and infrastructure. Access to a larger international market can increase the payoff from such investments.

Different modes of supply

Each of the four different modes of supply can yield benefits from increased variety, although each will have somewhat different effects on consumers and factor markets.

First, the different modes of supply will result in consumers having access to a different range of service variety and facing different costs.

The direct foreign investment option requires setting up a branch office and therefore incurring some fixed costs. In smaller countries, this means that, for services where foreign investment is the only option available, consumers will not have access to the full spectrum of services offered in larger economies.

Similarly, if consumers must travel to foreign countries to receive the foreign-provided service, they must incur fixed costs, such as travel and information acquisition. The presence of fixed costs on the consumer side also means that the full range of services available in larger countries will not be consumed by consumers in smaller countries. In both the direct-investment and customer-movement option, further gains from trade would be available if services could be traded directly or if service providers were allowed to cross borders.

On the other hand, the option of direct trade or movement of service personnel across borders both involve relatively lower fixed costs[7], but possibly higher variable costs. This means that

[7] In the appendix, I model these options as having no fixed costs.

the full range of services is available in a smaller country through these two modes, but foreign-provided services will be relatively more costly than local services.

In practice, the costs of providing services by each of the different modes of delivery will vary with the type of service. Moreover, liberalization in any one of the modes would no doubt stimulate technological advances in the cost of delivery via different modes. It is difficult to anticipate the relative costs and benefits of different modes of delivery, thus it is tempting to argue that consumers and service providers should be free to work out for themselves the most efficient mode of delivery—that is, one might expect that a free market would minimize the costs of service provision. It is unlikely, however, that full access via all modes would be the welfare-maximizing option for all countries. There are two reasons for this. First, in these models, firms have market power, and so price is always above marginal cost. This means that free markets do not necessarily provide optimum product variety or optimum outputs. Second, there are terms-of-trade effects due in part to differences in market size. As Markusen and Venables (2000) show, not all countries necessarily gain from a regime switch that allows multinational firms to emerge. When direct trade or movement of personnel is costly, large countries have an advantage, because their large market results in lower costs. Allowing multinationals to set up in smaller countries can erode some of the large country's advantage. Consequently, in their examples, smaller countries tend to gain from access to multinational-provided services, while larger countries may sometimes lose. Further research needs to be done on this issue in a model with all four modes of delivery.[21]

Second, different modes of supply also have different effects on factor markets. Direct trade, movement of customers and movement of service personnel all tend to increase the demand for labour in the exporter's market. Multinational establishment, on the other hand, tends to increase the demand

[21] The framework in the appendix could be used for a first pass at this question; however, once asymmetries across countries are introduced, even this simple model would become complex.

for labour in the host country. The effects of multinationals on specialized service personnel in the host country is more complicated, however, depending on whether foreign and local personnel in a given sector are substitutes or complements in general equilibrium. This suggests that political support for allowing foreign investment may be stronger than for the option of moving service personnel.

Spillover effects of piecemeal liberalization given product variety

Most studies of services trade in models with product differentiation tend to focus on only one service sector. With multiple service sectors, however, liberalization in one sector can have spillover effects on other service sectors. An example illustrates how these effects may be positive or negative (See the appendix for a fuller elaboration.).

Suppose two service sectors X and Y compete for workers with specialized expertise. Also, suppose that this specialized expertise is relatively scarce domestically. Then, consider the effects of liberalizing trade in X but not Y. Since domestic agents can now buy foreign services in X, the relative demand for domestic X services will shrink relative to Y services. That is, trade liberalization in X will result in specialized domestic personnel leaving the tradable X sector and moving to the non-traded Y sector. In fact, the domestic X sector may be completely eliminated after the opening of free trade in X services. However, in this case, free trade in X actually yields a double dividend to domestic consumers—consumers gain from increased product variety in X, as they gain access to the wider variety of foreign X services. They also gain from increased access to a wider variety of services in the non-traded Y sector, because trade has freed up personnel to expand that sector.

On the other hand, if the country is relatively abundant in specialized service personnel, the opposite can happen. Because of the country's comparative advantage in services, the X service sector will expand via trade, and this will draw personnel out of the non-traded Y sector. Consequently, the sector that is not liberalized can be squeezed by trade

liberalization in other sectors. This reduces product variety in the non-liberalized sector, and hurts consumers or producers who have a strong demand for its services.

Possible collapse of specialized local services

The discussion above focused on cases where there is symmetry in terms of the variety of services available domestically and abroad. With symmetry, consumers do not care if they consume local or foreign services, as long as the price is the same, but when local and foreign services are not symmetric, it is possible that exposure to foreign trade can cause the collapse of local services as they lose part of their customer base to foreign competition. It is also possible that this can be welfare-decreasing. This is an old result (See Snape (1977) and Curtis (1983).) but is worth re-emphasizing, since it captures some of the concerns of those who resist trade liberalization because they worry that foreign service providers may not be sensitive to local needs.

The basic point can be illustrated with a simple example.[22] Suppose there is some service that is supplied to local residents prior to trade liberalization. This service is an imperfect substitute for a foreign-provided service and has no foreign market as it is tailored to local needs. When the foreign service provider is given access to the local market, the demand for the local service declines.[23] If fixed costs are large, domestic firms providing the local service may be unable to generate enough revenue to cover their costs operating at the new smaller scale. Essentially, by siphoning off some of the local demand, the availability of the foreign service can render the local specialized service non-viable. This can cause the specialized

[22] For a detailed discussion of this example, the reader is referred to Appendix A4.

[23] One could imagine scenarios where either an income effect or a complementarity reverses this result, but my focus here is on the case where the local and foreign services are general equilibrium substitutes.

local service to collapse, even though it still might be socially efficient for it to be provided.[24]

This possible adverse effect on local specialized services is not necessarily an argument against allowing access to foreign service providers. There are several reasons.

First, the issue arises because markets are imperfect both before and after free trade, and the problem can be rectified by providing a subsidy to the local service provider. However, while this solution is simple in theory, it may be difficult in practice, since the government would have to select which local services should get the subsidy. Moreover, care would have to be taken in designing a trade agreement to ensure that such a subsidy is not ruled out as unfair competition. I will return to the discussion of these regulatory issues later.

Second, the possible loss of some localized services need not mean that an economy loses from trade liberalization. In practice, services trade liberalization will increase access to many services not previously available and will provide opportunities for domestic service providers to export. These benefits must be weighed against possible losses in some sectors.

Finally, two additional effects of trade liberalization can tend to work against the Snape result. If trade liberalization raises real incomes, this will tend to increase the demand for the local service. As well, if other services are used as intermediate inputs in the provision of the local service, then freer trade in services can reduce the cost of producing the local service. This would tend to increase the likelihood that the local services survive trade liberalization.[25]

---

[24] As shown in Appendix A4, it would be socially efficient to continue to produce the service if the consumer surplus exceeded the unrecovered costs of production.

[25] Technically, the inward shift of the demand curve for the specialized local service caused by the entry of the foreign service provider can be dampened and even possibly reversed due to the increase in local income stimulated by liberalization, while the marginal and or fixed cost curve may shift down. This could restore the pre-liberalization situation, where the average cost curve was below the demand curve for a range of output levels, leaving the industry potentially viable. The reader is referred to Appendix A4 for the diagrammatic exposition.

Standard models of trade that do not allow for emigration will understate some of the benefits to the average worker of services trade and investment liberalization. This can be illustrated by considering the effects of services trade liberalization on the incentives to emigrate.[26]

Suppose there are two types of workers. The majority of the population is able to work in either goods or services, while a smaller group of people have specialized human capital that is needed for the creation and maintenance of a firm producing a distinct service variety. Suppose also that the relative abundance of the two types of workers is similar across countries, meaning that their incomes are similar, but that the domestic market is relatively small, meaning that there is less variety in services and thus less enjoyment derived from consumption. Finally, we assume that those with specialized human capital vary in their attachment to their homeland. That is, the incentive (either a wage differential or greater consumption possibilities) that would prompt emigration varies across individuals.

If there is initially no services trade, then the variety of available services, and hence the consumption possibilities, is greater in the larger foreign country. This may be sufficient to prompt those domestic workers, both specialized and non-specialized, with the weakest attachment to their homeland, to want to emigrate. In the larger foreign country, immigration of specialized personnel increases product variety and consumption possibilities further, although it might depress incomes of the foreign specialized workers who now face added competition. On balance, the policy of accepting immigrants with these specialized skills might be expected to enjoy political support in the foreign country, since the non-specialized workers who only reap benefits are in the majority. However, the immigration of non-specialized workers would be less likely to find political support abroad, especially if there are any

[26] For a detailed technical development of this issue, the reader is referred to the discussion of "Piecemeal liberalization as a partial cure for the brain drain" in Appendix A3.

assimilation costs, because immigrating workers would be viewed as competition in the labour market and would produce no immediate tangible benefits in the form of increased product variety.

Consequently, the smaller country might be expected to suffer from an exodus of some specialized service personnel i.e. a "brain drain." Moreover, note that, if they do leave, the remaining domestic population is hurt, because domestic product variety falls, increasing the price for services.

If there were full free trade in all services, then all workers everywhere would have access to all varieties, removing constrained access to services as a source of incentives for migration. However, costless free trade in all services is not technically feasible. Nor, realistically, is trade liberalization in services likely to proceed except on a piecemeal basis.

To consider the effects of piecemeal liberalization on migration incentives, we develop a model with two service sectors. In this model, suppose we free up trade in one sector, but not the other. This will increase product variety in the small country in both the traded and non-traded service sectors. In the traded service sector, the increase in product variety is due to the entry of foreign service providers. In the non-traded service sector, the increase is caused by the shift of some specialized domestic service providers from the traded service sector under competitive pressure from foreign providers. Even piecemeal liberalization can therefore reduce the incentives for specialized service personnel to emigrate while, at the same time, yielding extra benefits to those who are unable to emigrate or who like living in their home country.[27]

Although the above results are formally derived from a model in which liberalization is effected by allowing foreign service providers to establish in the domestic market, they would likely hold regardless of the mode of supply that is liberalized. However, liberalization of different modes have different effects on the demand for the services of local specialized personnel. In particular, this can provide an added

[27] These results are formally derived in a theoretical framework in Appendix A3.

argument for negotiating reciprocal agreements for temporary mobility of specialized service personnel, even if trade is already liberalized through the establishment route, for example, if granted access to foreign markets, such workers may not only increase their income, but may also gain access to a wider variety of services at home. That is, facilitating reciprocal opportunities for temporary work in larger markets can reduce the incentives for a permanent move to the larger market.

Regulatory issues

One of the major weaknesses of the analysis up to this point in the paper, and indeed in much of the literature, is that the role of domestic regulation has not yet been considered. Most of the models reviewed and the model outlined in the appendix tend to predict that there are gains to both exporting and importing countries from liberalizing market access in services. There are a few qualifications, particularly if liberalization is only piecemeal. However, for the most part, the implications are much the same as for liberalization in the goods sector. In fact, all of the possible pitfalls of trade liberalization in services have analogues in goods trade. Particularly in the case of producer services, there may be a presumption that the gains from liberalization may be even higher than for goods trade because of their potential to increase productivity in many parts of the economy. Thus, if we were willing to take the leap of faith that goods trade liberalization would be beneficial, why has liberalization in services trade lagged?

The answer is twofold, as was discussed earlier. First, in the case of goods trade, countries were reluctant to sign agreements to allow labour or capital to move freely across borders, preferring instead to liberalize "embodied factor trade" only, and to retain the right to regulate movements of factors in accord with current domestic political and economic needs. Given that many services require movements of factors, this reluctance is a larger barrier to services trade than to goods trade.

Perhaps the critical issue in services trade is the role of domestic regulation. Regulation plays a role in goods production as well. However, in the goods sector, a simple distinction between process and product regulation can go a long way toward resolving regulatory conflicts. Generally, the norm in multilateral trade rules has been that countries exercise their right to regulate goods that may cause potential harm to their citizens via regulations on products. Goods can be inspected as they cross borders; and, under a pure national treatment rule, countries can apply any product standards or taxes desired, as long as these apply equally to domestic and imported goods. On the other hand, it is not generally accepted that countries have the right to try to regulate the process by which goods are produced in other countries. If the process generates a bad product, the product may be stopped at the border. However, as long as the product meets domestic standards, then the exporting country is generally considered to have the right to regulate the production process as it sees fit.

In practice, things are not quite so simple, as shown by recent disputes over such issues as environmental degradation abroad due to production and processing methods, fishing methods that endanger sea turtles, exploitation of child labour, use of prison labour, and so on. Moreover, rules that apply equally to domestic and foreign goods can in practice still be discriminatory, if they are only binding on the foreign products. Thus some version of "effective" national treatment may be called for, and issues pertaining to trade rules on products then become somewhat murkier.

However, although product regulation in international trade is not without its problems, regulatory issues in the services sector are far more complicated. This reflects the fact that much service regulation applies to the process by which the service is produced, or to the qualifications of those providing the service, rather than to the end product. The reason for this is that the product may be difficult to observe. The "product" may be person-specific, as in the case of surgery, and the product itself may be difficult to inspect. The characteristics of the product may only become apparent as time passes, and, moreover, it

may be difficult to isolate the effects of any given service provider on the long-run outcome..

Analytical work in this area is complicated, because an informative model of trade liberalization in the presence of regulation must include a reason for that regulation in the first place. Certain types of regulation may be in place only to restrict market access to service providers and thereby protect incomes of incumbent providers. In such cases, it is perhaps not unreasonable to treat regulations as no more than a standard trade barrier. However, other regulations are in place to protect the general public, and one cannot properly analyze the effects of an international agreement that affects such regulations without also modelling the purpose of the regulation.

A simple theoretical example can be developed to illustrate some of the issues that emerge when services trade is liberalized in the context of negative side effects or "negative externalities" that can be generated by the faulty provision of a service.[28] For the purposes here, it is useful to think of these externalities in terms of the *average amount of harm per unit of the service provided*. Because of these harms, regulation is imposed on the service providers both domestically and abroad. The issue then turns on the relative effectiveness of the domestic and foreign regulations in reducing the harms. If the foreign regulatory regime is more effective than the domestic regime, the average amount of harm per unit of the foreign service will be less than per unit of the domestic service. In this case, trade liberalization in this service sector is unambiguously welfare-enhancing, since, in addition to the standard gains from trade, there are benefits in terms of reduced harms, as better regulated foreign service providers take up part of the domestic market. If,

[28] This example is developed in formal terms in Appendix A2, in the section "Regulation with negative externalities." In many cases, the most appropriate modelling approach would be to explicitly model information and reputation problems, but this approach is left for future work. However, in many cases, externalities are relevant. Transportation services can cause accidents; medical errors may be costly to the general public when there is public insurance, and they may also have public health repercussions; education services generate externalities; and faulty construction practices can have impacts on those who did not purchase the services directly, and recourse via the courts may be costly.

however, the domestic regulatory regime is more effective, it is an open question whether the gains from trade outweigh the increased average level of harm that accompanies the entry of less well-regulated foreign service providers.

One of the implications of this analysis is that a country should pursue bilateral agreements (e.g. mutual recognition agreements) with countries whose regulatory regimes are as good or better than the domestic regime, since opening up trade with these countries will be unambiguously welfare-enhancing. Meanwhile, multilateral agreements become problematic unless a means can be found to either exclude suppliers from countries with weaker regulatory regimes, unless a way can be found to subject such firms to increased regulatory scrutiny.

Of course, as is well-known, the presence of externalities does not undermine the standard arguments for free trade, provided that these externalities can be internalized. However, in practice, this can be difficult in the case of services, because it will typically require that regulations be imposed on the process by which foreign services are produced, or on the qualifications of foreign service providers. Suppliers from countries with weak regulatory systems would have to be more intensely regulated locally. As well, there may be more difficulty enforcing regulations for suppliers from some countries than others, and this also would tend to push up regulatory costs for firms from such countries. Because regulatory intensity would have to vary with the supplier's source country, implementing a national treatment regime may also be problematic. If local authorities retain enough regulatory flexibility to deal with these issues, then, as we saw above, opening up the market to local suppliers will improve welfare. However, if local authorities are constrained by national treatment rules, then considerable care must be taken in liberalizing trade.

This analysis also suggests that multilateral liberalization may be easier via some modes of supply than others. For example, if the service is provided via foreign direct investment, it is fairly straightforward to apply domestic process standards and regulations to the foreign company's local service provision facility. Moreover, the issues here are much the same as the

application of process standards to foreign firms producing goods in the home country.

However, the other three modes of supply all raise more complex regulatory issues. If a service provider works in both the home and foreign country, then that provider could fall under local rules when working locally, which may involve excessive regulatory costs, if the service worker is satisfactorily regulated by the foreign country. Service providers from some countries may have received satisfactory training, while those in others may not. Ensuring that all foreign providers meet domestic standards may be costly. In fact, it is possible that a rule requiring non-discriminatory access to all (subject to domestic regulation) may actually reduce the gains from trade by imposing unnecessarily high regulatory costs.[29] On the other hand, extension of access only to a select few countries with similar or higher standards would incur few costs.

Similarly, if the service is sold over the border, access to the local market could be made conditional on meeting certain standards. Again, though, it may be efficient to vary the degree of regulatory scrutiny across sources.

Finally, if the client travels to a foreign country to receive the service, then again, regulatory scrutiny would have to vary across sources. For example, if training programs are offered in a foreign country, the domestic government would likely recognize some programs as meeting domestic standards for certain occupations, but not others. The costs of ascertaining this would likely vary across source countries and, while in principle a national treatment rule could imply application of uniform standards to all programs in all countries, in practice, the implementation of such a rule may be costly.

So, while at an abstract level the presence of domestic regulation does not detract from the standard argument for gains from trade, in practice, it raises a number of difficult problems. This suggests that liberalization will likely have to proceed

[29] In fact, the costs of regulation and the problems of designing national treatment rules for service providers operating in multiple jurisdictions may render foreign direct investment a superior mode of supply for some services, even when it may not be the least costly way of servicing the local market when regulatory issues are ignored.

along different tracks for different services and different modes of supply. In some cases, liberalization may have to be delayed because of the complexity of multi-jurisdictional regulatory issues.

Local content: Another regulatory problem

A different type of regulatory problem arises when there is a *positive* externality or spillover from local service production. That is, suppose there is some benefit to society at large from domestic consumption by an individual of some domestically produced service. For example, this may be the case with domestically produced education or cultural services. It may also be possible that domestic consumption of some local services helps to create a sense of community as well.

If there is a collective decision that some such service is beneficial to the community in a way not captured by market prices, the provision of this service at an optimal level requires either a production subsidy or public provision of the service. In technical terms, direct public provision of the service or a subsidy to ensure optimal levels of private provision *internalizes* the externality and thus removes the market failure.

Normally, granting access to foreign providers can be welfare-improving, both because of potential comparative advantage effects, and because of the benefits from increased product variety. However, because of the positive externality associated with the local service, it is not desirable for foreign and domestic firms to compete on a level playing field, since that can lead to sub-optimal provision of the local service.[30]

Consequently, care must be taken in defining the terms under which trade liberalization occurs. Granting national treatment status to foreign service providers would be a mistake in such circumstances, if national treatment required that any subsidies made available to local service providers were also

[30] This argument is similar to, but not the same as, the optimum product variety argument given above. In that case, fixed costs meant that a local variety was squeezed out by foreign firms. In this case, there need not be any fixed cost.

made available to foreign providers who sold services in the domestic market (in any of the modes of delivery).

If the government loses the flexibility to give a discriminatory subsidy to local service providers, then it can lose the ability to internalize the externality, and trade liberalization can reduce welfare because of the constraints it places on the electorate's ability to get the government to set appropriate internal domestic policies.

It is important to emphasize that this analysis is not an argument against trade liberalization. As noted above, the first best policy for this country is free trade combined with internalization of the externality. Rather, the point of this analysis is that careful consideration must be given to the rules under which a liberal trading regime operates. For some types of industries, there are no externalities, and a national treatment rule may create no issues. However, for other types of industries, this type of rule can cause problems, because it eliminates the flexibility of the government to deal efficiently with internal domestic-policy concerns. Since national treatment is the foundation of trade liberalization, however, an alternative interpretation of this analysis is that the government may want to exempt certain sectors from a services trade agreement to ensure that it maintains the flexibility to deal with domestic policy objectives.

Domestic versus foreign regulatory costs

When the government is engaged in regulation, it often enacts policies that harm some firms or consumers (by reducing their opportunities to generate income). In some cases, such as when land is expropriated to build a highway, those harmed by the government decision can reasonably expect compensation. In other cases, such as when air-quality regulations are tightened, consumers and firms are expected to bear the compliance costs themselves. Each country's legal and political systems have a set of rules and traditions that govern such problems, and some are more effective than others.

One of the benefits of trade agreements is that domestic and foreign firms can expect to operate under similar rules when

servicing a given market. This means that foreign firms can have more confidence that investments they make to service a given market will not lose value because of arbitrary discriminatory regulation. However, care must be taken in designing the set of rules under which foreign firms can expect to receive compensation in the event that a move by the domestic government reduces their market access or the value of their investment.

If foreign firms can appeal either directly or through their governments to international dispute-settlement panels, while domestic firms rely only on the internal legal system, then foreign and domestic firms have different avenues of redress. This may create an imbalance between the power of domestic and foreign firms in negotiating with governments when regulatory changes are considered. Thus, while granting market access to foreign firms is likely to be beneficial to the home economy, care must be taken about the legal basis under which this access is granted.[31]

Other issues

A number of issues relevant to services trade and investment liberalization have not been explicitly covered in this chapter, but are worthy of attention in future work.

Asymmetric information issues

For many types of services, important information about the client may not be in possession of the service provider (e.g. an insurer may not have full information about the driving safety of an applicant seeking auto insurance, who is, of course, in full possession of this knowledge); or, conversely, important information about the service provider may not be known to the client (e.g. a patient may not have full information about the ability of a given physician in performing a procedure that the patient requires, while the physician would know). These

[31] See Markusen and Venables (1998) for a discussion of the relative merits of right-of-establishment rules in a developing country context.

situations provide examples of the problem of *asymmetric information*. In some cases, these types of issues can be dealt with adequately in the market via reputation effects. However, in most cases like this, there is also government regulation. The problem of asymmetric information has been widely studied in the economics literature, but there has been relatively little attention given to the international provision of services that are subject to asymmetric information. Dixit (1990), Grossman and Horn (1988), and Bagwell and Staiger (1989) have done some work in this area, but there is a need for more work to study the implications of different modes of supply and their interaction with the regulatory systems of the client and provider countries.

Quality of services

A benefit of international trade not yet discussed is that, by increasing competition and creating a large market, it enables consumers to gain access not just to more services at possibly lower costs, but to higher-quality services as well. There is some literature on the effects of trade on product quality, but more work here would also be fruitful. The effects of trade on the quality of services may be particularly difficult to measure, and, if this effect is ignored, the estimated benefits of free trade would be biased downward.

Effects of services trade liberalization on the structure of firms

Many services facilitate transportation and communication between firms. As well, they affect the property rights regime and the efficiency with which contracts are enforced. Firms' decisions about whether to produce inputs internally or contract with outside firms (either domestic or foreign) are determined by transportation costs, communication costs, legal costs, and various other types of transaction costs. Services trade liberalization affects these costs and therefore affects the organization of firms in terms of equilibrium structure and scope of their activities. Much trade theory tends to avoid a detailed modelling of the structure of firms. However, the issue

of the endogeneity of firm structure is likely to be very important for some aspects of services trade liberalization.

Networks

Many services are provided via networks (such as telecommunications, distribution, air transport, etc.). A careful analysis of trade and investment liberalization in these sectors requires a model of networks that interacts with the trade regime. Little work along these lines in an international context is available.

Political economy

The interaction with the domestic policy process is perhaps the major issue in services trade liberalization. Many discussions of this issue adopt the targeting approach due to Bhagwati and others. In this approach, free trade is the best policy, provided benevolent governments use the appropriate instruments to correct market failures. In practice, governments do not act this way; domestic policy is a political compromise. This suggests that the effects of service trade liberalization should be more appropriately analyzed in a model with an endogenous domestic policy process driven by political economy considerations.

Empirical studies

Three types of empirical studies are potentially relevant to the theme of this paper:

- studies that attempt to measure the size of barriers to trade and investment in services;
- empirical studies that attempt to test some of the hypotheses about the consequences of services trade; and
- computable general equilibrium models that simulate the effects of trade liberalization.

I will discuss each of these areas in turn; however, as noted at the beginning of this paper, my review of the empirical

evidence will be relatively brief, because there already exist some good recent surveys of this work.[32]

Measuring the size of trade barriers

Measures of the size of trade barriers are very important, because they can help policymakers to identify sectors in which domestic access to foreign markets is restricted. They can also give an indication of which domestic sectors will be most exposed to increased competition when trade is liberalized. As well, measures of the size of trade barriers are an essential input into computable general equilibrium studies. One cannot attempt to simulate the effects of a reduction of trade barriers without good estimates of the barriers. Also, time-series measures of trade barriers are also needed for empirical work that tests hypotheses about the effects of reductions in trade barriers.

The literature on measuring trade barriers in services has been recently surveyed by Schembri and Chen (2001), as well as in the first part of Brown and Stern (2000). This literature continues to face several major difficulties. Most trade barriers take the form of regulatory restrictions, rather than simple taxes on trade. This makes them very difficult to quantify. In most cases, one cannot assess the protective effect of a regulation without having a model of the economy to predict how trade flows and prices would be different in the absence of the regulations. This means that it is very difficult to measure trade barriers without first having a good understanding of the fundamental forces driving services trade.

As well, many regulations in the service sector that impede trade exist because of governments' responsibilities to address important public-policy problems such as dealing with asymmetric information problems, and protecting health and safety. This makes it very difficult to isolate the protectionist

[32] See Hoekman and Braga (1997), OECD (2000), Schembri and Chen (2001), and Markusen and Maskus (2001). (The latter focuses on general equilibrium models with multinational firms; the theory behind this was surveyed above. This is the literature that comes closest to endogenizing the mode of service supply.)

effect of regulatory barriers to services trade. In many cases, there may be a different set of regulations that would address public-policy concerns, but in a less trade-distortionary way. It is difficult for an analyst to measure the potential drop in the level of protection that would come about from introducing less trade-distortionary regulations without a great deal of institutional knowledge about specific sectors. This suggests that much of the work on measuring the size of trade barriers will have to proceed on a sectoral basis, while, at the same time, remaining cognizant of potential general equilibrium effects. Fink, Mattoo and Neagu (2001) provide a good example of the sectoral approach by studying barriers to trade in the maritime shipping sector.

Hypothesis testing

The second type of empirical work that is relevant here would explicitly attempt to test hypotheses about the forces determining the direction, volume and effects of services trade. For example, it would be useful to know whether trade in goods and services are substitutes or complements; and whether trade in services is generated more by differences between countries, or by product differentiation and market niche motives. As well, it would be useful to assess the actual effects of previous trade liberalization on productivity, wage distribution, access to product variety and other variables of interest. Unfortunately, there is relatively little work that explicitly assesses services trade. There is a great deal of recent work that attempts to test the major theories of international trade, although the focus has been on goods trade, primarily because of data.

Markusen and Maskus (2001) survey work on general equilibrium models of multinational firms. This is particularly relevant for services trade, because commercial presence (foreign direct investment) is one of the most important modes of supply. They find that there is considerable support for the view that similarities between countries tend to be strongly associated with the presence of multinational firms. This is consistent with the view that commercial presence is a substitute for direct trade in services. As well, they find support

for the notion that foreign direct investment is complementary with trade in intermediate products. That is, the establishment of foreign branches tends to increase trade in intermediate goods and services.

Computable general equilibrium models

The third type of empirical work, that based on computable general equilibrium (CGE) models, is perhaps the major source of estimates of the consequences of the effects of trade liberalization. In this literature, the analyst specifies a model that is based on one or more of the theories discussed in the previous section and implements it on a computer. The use of computers allows the models to be implemented on a larger scale, with potentially many different sectors and types of inputs. To implement the model numerically, the analyst requires many parameters, such as demand and supply elasticities. These are sometimes estimated and sometimes taken from the literature. As well, some parameters are left free, so that the model can be calibrated to replicate the endogenous variables for a base year. Once the model is calibrated, simulations can be run to assess the effects of changes in trade barriers on the pattern of trade, prices, income distribution and welfare.

CGE models are attractive, because they yield precise quantitative predictions about the effects of trade liberalization. However, they do not really constitute empirical evidence that can be used to support one particular hypothesis about the effects of trade liberalization over another. This is because the results from the models are dependent on what theory the analyst uses to set up the model in the first place. The results can be very sensitive to how the model is set up. As well, because most such models are calibrated, rather than estimated, one cannot calculate confidence intervals to help assess the significance of the predictions. For these reasons, one should resist the tendency to read too much into the magnitudes of the numerical estimates of the effects of trade liberalization that are generated by these models.

CGE models are, however, a useful complement to analytical theory. As mentioned above in the survey of the theoretical literature, there are many cases in theory where there are conflicting forces at work. For example, in product-differentiation models, a worker might be predicted to lose via a fall in wages as a result of trade liberalization; at the same time, the worker might be predicted to gain because of lower prices and increased variety of products available. A CGE model helps to identify which types of forces are likely to be "large" and which may be of only second-order importance. If enough sensitivity tests are run, this can help to generate a richer understanding of what the different theories predict about the effects of trade liberalization. CGE models can therefore help to generate hypotheses that empirical researchers can investigate. Moreover, useful synergies can develop. CGE models can help to generate hypotheses that can be tested, and the results of the hypothesis testing can be used to help develop better CGE models.

The CGE literature on trade in services has been thoroughly surveyed very recently by the OECD (2000). However, it is worth pointing out how some of the results from these studies relate to the theoretical work discussed above.

There are two very broad classes of CGE models available for studying services. In some models, services are treated very much like goods, and there is no allowance for different modes of supply. Some of the models allow for trade to be generated both by factor-endowment differences as well as product differentiation. Some recent models [starting with Petri (1997)] allow for multinational firms, which endogenously choose whether to export or to set up a branch plant. As well, some models allow for producer services as an intermediate good along the lines of Markusen, Rutherford and Tarr (2000).

All of these models predict that liberalization of services trade and/or investment will increase real global income. However, the distribution across countries of the gains from liberalization tends to be very sensitive to how the models are specified.

In models without endogenous treatment of foreign direct investment, the gains from services trade liberalization tend to

be positive throughout the world. Several of these studies provide estimates of the gains to Canada. Brown et al. (1996) find that Canada's GDP would rise by about 0.7 percent from a 25 percent reduction in services trade barriers. Chadha et al (2000) simulate the effects of a multilateral 33 percent reduction in services trade barriers in the year 2005 and find welfare gains throughout the world. Canada's welfare measure rises by 2.8 percent. Benjamin and Diao (2000) use a model that lacks some of the product differentiation channels of the previous two studies, and finds smaller, but still positive, welfare gains of 1.35 percent for Canada from multilateral services trade liberalization. Overall, these studies suggest that liberalized services trade will generate gains to countries throughout the world, and that Canada will share in these gains. The magnitude of the overall gains is relatively small, considering that the reductions in trade barriers are large, but the magnitudes of the gains are similar to those that were obtained in earlier simulations investigating the effects of freer goods trade.

Earlier in this chapter, it was pointed out that theory does not unambiguously predict that countries will uniformly gain from services trade liberalization. First, it was noted that liberalization of trade in services will affect world prices of goods. This raises the possibility that some countries may experience terms-of-trade losses from services trade liberalization. Second, it was noted that, because services trade liberalization will be piecemeal, the types of trade barriers and the sequencing of liberalization could affect whether or not all countries gain. In particular, it was suggested that the distribution of the rents accruing to producers that benefit from protection could influence welfare outcomes. Many economists tend to dismiss these types of concerns as being interesting in theory, but of little practical importance. Indeed, when looking at the CGE studies mentioned above, this scepticism finds support. For example, Brown et al. (1996) calculate terms-of-trade changes resulting from service trade liberalization, and find that Canada's terms of trade do in fact worsen slightly by 0.1 percent, but this effect is more than offset by other gains from trade and thus Canada gains overall.

However, two recent studies that explicitly treat foreign direct investment as a mode of service supply find very different results. These studies suggest that terms-of-trade effects and other seemingly second-order concerns cannot always be dismissed as minor. Dee and Hanslow (2000) find that services trade liberalization raises overall world income, but that both the United States and Canada, as well as some other countries, experience small welfare losses from services trade liberalization. Their model allows for liberalization of restrictions on foreign direct investment as well as on trade. Welfare losses can potentially come from three sources. First, removal of restrictions on foreign investment can divert capital to countries that previously had relatively high barriers to investment. Second, barriers to entry generate rents, some of which accrue to owners of foreign capital. With liberalization, these rents are eroded by competition, and thus countries that are important sources of foreign direct investment can lose. Finally, there are terms-of-trade effects as discussed above. Dee and Hanslow attribute the loss to the United States as primarily due to rent losses, while losses to Canada are primarily due to terms-of-trade effects. Negative terms-of-trade effects for Canada also appeared in Brown et al. (1996) as noted above, but these effects are magnified in the Dee and Hanslow study by the increased capital mobility. Dee and Hanslow express considerable caution in interpreting their results because of data problems.

Brown and Stern (2000) seek to improve on their previous work (Brown et al., 1996) by incorporating an explicit treatment of foreign direct investment, as well as some of the production structure from Markusen, Rutherford and Tarr (2000). Their results are surprising in that they obtain relatively large predictions of welfare effects from services trade liberalization. They again find that the world gains as a whole, but that some countries lose. They report six different simulations, each with various different assumptions on capital mobility or demand. Canada loses from a multilateral reduction in services trade barriers in each of these scenarios, with the changes in welfare ranging from −0.71 percent to −7.56 percent. Conversely, economies such as Japan and Hong Kong experience large

gains. The United States gains in some scenarios, but loses in others. Brown and Stern note that welfare losses in their model tend to be associated with capital outflows due to increased opportunities for investment in other parts of the world.

Finally, it should be noted that these results all come from scenarios where everybody liberalizes services trade. Brown and Stern did not run scenarios where the rest of the world liberalizes, but Canada does not. They speculate (on p. 20) that, in such scenarios, the losses to a country like Canada would be even higher, if Canada did not liberalize. This echoes a point made in the theory section earlier in this paper. If the rest of the world liberalizes, then world prices change, and a country may lose. However, these losses are more or less beyond the control of the losing country. The theory predicted that maintaining barriers in the face of liberalization by everyone else would, in fact, compound losses.

As noted above, CGE studies should be viewed as an adjunct to theory. They help us to understand which types of forces may be important and how different forces interact with each other in sometimes surprising ways. One should not read too much into particular numbers generated for particular countries.

There are two conclusions from recent work in this area. First, the predictions for individual countries are very sensitive to the modelling structure. This suggests that we need to develop a much better understanding of the forces that are driving trade and investment and of how regulations in the services sector translate into trade barriers. In other words, the application of CGE models to the services sector is a relatively new undertaking; the models are useful for research purposes, but must be treated with caution as a guide for policy. Second, the models do demonstrate that some of the complexities and ambiguities that arise in a theoretical treatment of services trade liberalization cannot be easily dismissed as being of second-order importance. The sequencing of liberalization and its interaction with pre-existing goods trade may well be important in influencing welfare outcomes.

Policy Implications

The preceding discussion suggests that there is much work remaining to be done, before we have an accurate assessment of the benefits and costs of services trade liberalization. However, a few preliminary policy directions may be suggested.

Liberalize in cases where regulations mainly protect against entry

In cases where the main effect of regulations is to restrict entry and to protect incomes of incumbent service providers, there is a strong case for exploring the possibilities of further liberalization. Increased competition and greater variety of services available from foreign service providers will benefit both producers who use services as intermediate goods and also final consumers. As well, potential Canadian service exporters will benefit from increased opportunities arising from access to larger markets. In such cases, liberalization via each of the four modes of delivery should yield gains, and competition in the market should help to ensure the most efficient form of service delivery. However, the option of allowing foreign service providers to move personnel across our borders would have repercussions for our general approach to labour mobility and should be considered in the context of the larger issue of how Canada wants to treat temporary movement of workers in any sector.

Gains come from imports as well as exports

Canada currently has a trade deficit in services. Further liberalization may or may not increase this deficit. However, the deficit or surplus in services trade is not an indicator of the benefits to the economy from services trade liberalization. All consumers benefit from access to a wider variety of services provided more cost effectively. At an aggregate level, these types of benefits can be substantial, even though individual consumers may not see the gains as large enough to justify lobbying for liberalization on their own. As well, liberalization

of producer services can enhance productivity in other parts of the economy, including other export sectors.

Increased trade in services can help to attract and keep talented people in Canada

In cases where some services are not tradable directly, service providers may find that they are better off in large markets than in small markets. Some of them will have an incentive to emigrate to take advantage of increased business opportunities but also to take advantage of a wider variety of services for their own consumption. Moreover, the destination countries will have incentives to allow them to immigrate. The loss of such local service providers can have negative effects on those who either choose not to leave or cannot leave; this reflects the loss of local product variety and increased costs due to increased difficulty in accessing producer services. Liberalizing services trade via any or all of the four modes of delivery can create added benefits, since it may reduce the incentives to emigrate. By increasing the range of services available locally, trade makes the local market a more attractive place in which to live. Also, by providing access to foreign markets, trade agreements make available to local service providers increased opportunities to pursue their careers from a base in the local market.

Identify complementarities

Many types of services are complementary to goods trade. As well, many services are complementary to other types of inputs within the same sector, at either a partial or general equilibrium level. If granting access to foreign service providers increases the demand in the same sector, then broad political support should be expected. The movie and television production industry seems to be an example where this approach has worked well (e.g. allowing foreign stars to act in local productions increases demand for local actors).

Be aware of possible linkages between liberalized and non-liberalized sectors

Because services trade liberalization will likely proceed on a piecemeal basis, it is important to be aware that possible spillover effects from liberalization could be important in some sectors but not in others. As the analysis indicated, when product variety is important, liberalization in one sector can, in some circumstances, squeeze and reduce product variety in other sectors. As well, when a few foreign service providers have privileged access to the local market, they earn rents from this access, and piecemeal liberalization can increase these rents, which shows up as a cost to liberalization. One way to mitigate this effect is to try to liberalize in sectors where there are rent-generating entry barriers.

Care must be taken to ensure that the details of the free trade agreements leave governments with sufficient regulatory flexibility to deal with domestic-policy concerns

In those cases where regulations deal with market failures, such as health and safety regulation, consumer protection, correction of externalities, etc., care must be taken to ensure that governments maintain enough flexibility to regulate effectively and to be able to change their regulatory approach in response to demands of the electorate and innovative ideas in how to regulate. In some cases, simple mutual recognition agreements are likely to be the most cost-effective approach to regulation; however, this may not a desirable approach in all sectors or for all countries within a sector. In other cases, harmonization of standards may be desirable, although this may only be feasible within a subset of countries. In other cases, a national treatment rule requiring that all providers meet Canadian standards would be appropriate. The general conclusion here is that the details of liberalization are likely to be very important in cases where domestic regulations are important.

National treatment rules can be problematic for some types of services

For some types of services (such as some aspects of culture and education) there are positive externalities from local provision. Moreover, the perceived benefits from local provision may change over time as cultural norms change. Governments should maintain the flexibility to give preference to local service providers in such cases. If national treatment with respect to subsidies is granted to foreign service providers, governments may be unable to internalize the externalities that are prevalent in these sectors. This suggests that some sectors will have to be exempted from full liberalization for regulatory reasons. Moreover, flexibility in this area must be maintained, so that present views on the role of government do not unduly constrain future government policies.

Conclusion

The main forces yielding benefits and costs in services trade liberalization are much the same as those that applied to goods trade liberalization. Gains arise from comparative advantage and access to a wider variety of services. Increased competition erodes market power, and access to large markets can allow firms to increase their productivity via scale effects. Whether the potential gains are larger or smaller than in the case of goods trade is difficult to assess. Some types of producer services can have potentially larger productivity-enhancing effects. Also, trade in services can stimulate trade in goods, generating yet further gains from trade. However, pre-existing trade in goods, as well as pre-existing services trade means that some of the potential gains from trade in factor services have already been realized via embodied factor services trade.

The potential costs of services trade liberalization are also familiar from our experience with goods trade. Trade liberalization can displace workers and firms, and redistribute income: some people gain, while others lose. If there are market failures that are not corrected by governments, trade can sometimes exacerbate these distortions. As well, when trade

liberalization proceeds on a piecemeal basis, it can have unintended harmful spillover effects into other protected sectors of the economy.

However, while there is not really much difference between services trade and goods trade at an abstract level, there are major differences at a practical level. Because many services cannot be directly traded for technical reasons, liberalization of services trade requires liberalization of rules affecting foreign direct investment and the movement of personnel across borders. Governments have been willing to allow both but have been reluctant to commit to multilateral agreements on these issues.

Because services are a process, government regulations of services are process rather than product regulations. Process regulations are common in the case of goods, but these regulations usually only apply to production within a country – once goods enter into trade, product regulations tend to take over. However, since foreign service providers tend to be selling a process rather than a tangible good, regulations affecting imports will be regulations affecting the process by which the service is produced. That is fundamentally different than what goes on in goods trade and is perhaps the most serious impediment to services trade liberalization.

One of the key insights from international trade theory is that free trade is beneficial for a country, as long as governments maintain the flexibility to correct market failures and meet equity concerns. Rather than hindering efforts to achieve high levels of environmental quality, a healthy and safe work environment, or social services, trade can actually enhance these efforts by raising national incomes and creating options that wouldn't otherwise be available. The challenge is to design a set of trade rules that preserve this flexibility while, at the same time, increase opportunities for Canadians to gain access to foreign markets, and increase opportunities for Canadian consumers to access foreign services. This is perhaps the major issue in services trade liberalization, but one that has received relatively little attention in the formal literature on international trade and investment. More work in the area needs to be done.

Technical Appendix

This appendix provides some technical background to support some of the arguments in the main text, adding some details and rigour in developing the conclusions. As well, it explores the possibility of addressing some of the gaps in the literature in a very preliminary way.

A theoretical framework

Ideally, one model could combine features of the main approaches to modelling services trade; and, in fact, some papers do use aspects of different approaches. The Markusen and Venables (2000) paper nicely integrates the comparative advantage motive for trade with the product differentiation motive. It also allows for two modes of supply: direct trade and multinational firms. One could, in principle, extend this approach to allow for producer services and other modes of supply, including movement of persons and movement of consumers.

However, to gain insight into the main channels through which benefits and costs of service trade liberalization will be realized, it is useful to focus on simple models that highlight one or two important forces. The more comprehensive the model, the more difficult it is to understand the issues. Computer simulation models can be useful to investigate how the different forces interact with each other, but one has to remember to approach such models with just as much scepticism as pure theory models, since the results can be sensitive to model specification and choice of parameters.

In this appendix, I set out a simple theoretical framework to analyze the benefits and costs of services trade at a general level, without focusing on the special characteristics of individual services. I then select three special cases to highlight a few important issues. The approach here is not a new model—the first part is simply an application of the standard competitive trade model, and the second part is a simple version of a differentiated products model based on Brainard (1993) and Markusen and Venables (2000). I investigate all four modes of

service supply, but do not attempt to render the choice of mode of supply endogenous—it is determined by the regulatory system or a trade agreement. The purpose is to give the reader a flavour of the approaches and to highlight a few key issues.

Throughout, I assume there is pre-existing free trade in goods. One could allow for trade restrictions in the goods sector. This would add some complications—as is well-known, for example, increased capital mobility need not improve welfare, if it stimulates output in protected sectors. However, these issues are fairly well-understood, and, given the relatively low trade barriers in the goods market in Canada at this point, I just focus on the case of free goods trade.

I assume either one or two service sectors at various points in the analysis. Most of the literature tends to assume only one service sector; however, because services trade liberalization will likely proceed on a piecemeal basis, it is useful to allow for more than one service sector to consider the spillover effects of liberalization from one sector into another unliberalized sector.

I begin by assuming that services are a homogeneous product produced with constant returns to scale and directly consumed by consumers. This facilitates a discussion of comparative advantage motives for trade, and the interaction between trade in factors, and trade in final services and goods.

I then suppose that services are a differentiated product along the lines of Krugman (1980), Brainard (1993), and Markusen and Venables (2000), and compare the four different modes of supply. A firm may export directly, send service providers to a foreign country, set up a branch office, or service foreign consumers at its home office. I assume that moving workers across borders is costly, and the consumers must pay fixed travel costs to come directly to the foreign providers. The choice of mode of supply is not, however, endogenous in the model; that is left for future work.

Finally, I suppose that the services sector is regulated, and I investigate the implications for trade liberalization. I model regulation only in a couple of very simple stylized ways, and revert to a very simple version of the competitive model. I first consider a case where there is a positive externality from production of the home variety of a service. This captures issues

such as a desire to promote domestic culture or domestic public education. I then consider the possibility that service providers may unintentionally cause harm as a side effect of their activities and model this as a negative externality.

Because of this, service providers are regulated. However, regulation is costly and therefore regulatory intensity will vary across countries.

A1. Service trade and investment liberalization in a standard competitive trade model

Let Z be a vector of tradable goods, and let X and Y be services. In general, goods and services can be used as both final and intermediate goods; if there are intermediate goods, then outputs in the model are treated as net outputs. There is a vector of factor endowments v. There is a representative consumer with preferences represented by an expenditure function $E(p_Z,p_X,p_Y,u)$. The production side of the economy is convex and perfectly competitive, and so can be represented with a national revenue function $G(p_Z,p_X,p_Y,v)$. Both E and G satisfy the properties implied by the standard competitive trade model (see Dixit and Norman, 1980, or Woodland, 1982). Compensated demands can be recovered from E by differentiating with respect to prices, and net outputs can be recovered from G by also differentiating with respect to prices. Factor prices can be recovered from G by differentiating with respect to outputs.

I assume that there is free trade in goods, but that trade in services may be restricted either by market access restrictions (captured here by quotas) or by regulations that raise the cost of servicing the local market, which I capture here by including trading costs that are proportional to the foreign price. The budget constraint of the economy is given by:

$$E(p_Z,p_X,p_Y,u) = G(p_Z,p_X,p_Y,v) + \lambda_X M_X[p_X - (1+\alpha_X)p_X^*] + \lambda_Y M_Y[p_Y - (1+\alpha_Y)p_Y^*]$$

where an asterisk indicates the foreign price, M_i is imports of i, λ_i is the fraction of quota rents accruing to the home country,

and α_i is a measure the "red tape" costs of selling the foreign service in the home market.

Suppose that there is initially free trade in goods, so that p_Z is determined in world markets. Suppose that services in the X sector are import-competing and are initially not traded. Services in the Y sector are imported but may be subject to a binding quota. It is straightforward to handle exported services in the same way; I focus here on imports for expository purposes.

Let us now consider the welfare effects of liberalizing trade of X services. Totally differentiating and rearranging yields:

$$E_u\, du = \lambda_X[p_X - (1+\alpha_X)p_X^*]dM_X - \lambda_X M_X p_X^* d\alpha_X - (1-\lambda_X)M_X dp_X - (1-\lambda_Y)M_Y dp_Y + \lambda_Y[p_Y - (1+\alpha_Y)p_Y^*]dM_Y - M_Z dp_Z \quad (1.1)$$

Services trade liberalization will affect welfare through both direct effects and spillover effects. To understand these effects, it is useful to consider different special cases.

Unilateral liberalization in a small country; Home gets the quota rents

If Y is protected with a quota, then $dM_Y = 0$ and, if Home gets the quota rents, then $\lambda_X = \lambda_Y = 1$; and, if it is small, then $dp_Z = 0$. Then (1.1) reduces to:

$$E_u\, du = [p_X - p_X^*]dM_X \varepsilon\, 0. \quad (1.2)$$

Unilateral services trade liberalization in the X sector, without liberalizing Y must improve welfare in this case via a direct gains-from-trade effect driven by comparative advantage, provided that the foreign and domestic prices differ. As noted in the main text of the paper, it is possible that trade in goods alone equalizes services prices across countries, and, in this case, there are neither losses nor gains from services trade. However, if services prices differ, there are gains from trade whether Home exports or imports X, although here I focus on the importing case.

It is noteworthy that piecemeal reform is welfare-improving in this case. If instead, Y were protected by tariffs, then trade liberalization in X could exacerbate the distortion in Y and actually reduce welfare. However, as Falvey (1988) showed, this is not the case when there are quota restrictions in place and Home collects the quota rents. This is an important result, since services trade liberalization is likely to proceed in a piecemeal fashion.

Small country, multilateral liberalization

Somewhat paradoxically, however, *multilateral* liberalization may not improve Home's welfare. Global liberalization of services will generate general equilibrium effects that can be expected to affect tradable goods prices (Z prices). In this case, we have:

$$E_u\, du = [p_X - p_X^*]dM_X - M_Z dp_Z \qquad (1.3)$$

These price effects may benefit or harm Home, depending on whether Home's terms of trade improve or deteriorate on average. Although these terms-of-trade effects could potentially generate losses, there is nothing that Home can do about it on its own. Home cannot offset globally generated terms-of-trade effects by failing to liberalize itself. In fact, by failing to liberalize, Home suffers from the terms-of-trade effects, but fails to reap the direct gains from trade. Home could potentially attempt to avoid losses from a negative terms-of-trade effect by forming a coalition with other countries to try to affect the type of global liberalization that occurs and thereby influence the terms-of-trade changes. However, these effects will be difficult to predict and thus such a strategy is impractical.

Large country

If Home is a large country, then it is big enough to affect world prices. In this case, a standard gains-from-trade result does not hold. Referring to (1.3), since Home is big, even unilateral service trade liberalization can affect other tradable goods prices. Home gains, if the direct gains from trade offset any

potential terms-of-trade deterioration. This is an empirical matter.

Red tape as the only source of protection

Henceforth, I assume that there are no terms-of-trade effects in the goods market in order to focus on other issues; this can be justified if Home is small and unilaterally liberalizes. Extending the analysis to include terms-of-trade effects if they arise is straightforward.

If the only source of protection is regulatory costs (so that there are no quotas restricting market access), then the effect of a change in regulatory costs that improves market access in X but not Y is:

$$E_u\, du = - M_X p_X^* d\alpha_X > 0$$

since $p_X = (1+\alpha_X)p_X^*$ and $p_Y = (1+\alpha_Y)p_Y^*$, and $d\alpha_X < 0$; and since I have ruled out terms-of-trade effects in the goods market. If services trade restrictions take the form of regulatory or trading costs, then piecemeal reform is again welfare-improving.

Foreigners get all the quota rents

If a limited number of foreigners are allowed to operate in the domestic market, they would be paid prevailing domestic prices, and so would collect the quota rents themselves. In this case $\lambda_X = \lambda_Y = 0$, and, if the country is small, then (1.1) reduces to:

$$E_u\, du = - M_X dp_X - M_Y dp_Y$$

If Home imports X, then $- M_X dp_X > 0$, since the domestic price of services will fall as imports rise. That is, Home will experience gains from trade in the liberalizing sector. However, changes in the local X market will in general affect both the domestic demand and supply for Y. If X and Y are complementary in production, then a contraction of the local X sector could also lead to a contraction of Y, pushing up p_Y. If Y

is imported, then this will harm Home by pushing up the price that foreigners are paid for local sales of their services. Alternatively, if liberalizing X increases local demand for Y, p_y could rise; again, this will harm Home via a terms-of-trade effect in Y. That is, Home could suffer a terms-of-trade loss, if trade liberalization is piecemeal. The net effect on trade liberalization depends on the size of the direct gains from the trade effect relative to the spillover effect. Piecemeal trade liberalization in the services sector may not guarantee a welfare improvement, even if all services are protected only with quota restrictions. This is because spillover effects into other protected markets may occur, if foreigners collect the quota rents.

A2. Regulatory issues

Positive externalities generated by local production of X services

Suppose now that locally produced X services generate positive externalities, as discussed in the text of the paper. Examples could include cultural activities, education, etc. Then local output of X enters the expenditure function, so that it is represented as $E(p_Z,p_X,p_Y,X^H,u)$, where X^H is Home production of X, and where E is decreasing in X^H to reflect the positive externality. To avoid spillover effects into the Y sector, let us suppose that the country is small and there is free trade in Y services, and also suppose that X is protected only with a quota so that $\alpha_X = 0$. Then the budget constraint is

$$E(p_Z,p_X,p_Y,X^H,u) = G(p_Z,p_X + \theta,p_Y,v) + \lambda_X M_X[p_X - p_X^*] - \theta X^H,$$

where I have allowed for a subsidy θ for domestic X production.

The welfare effects of allowing increased service trade in X are given by:

$$E_u\, du = \lambda_X[p_X - p_X^*]dM_X - (1-\lambda_X)M_X dp_X - (\theta + E_X)dX^H$$

If the externality is fully internalized, then $\theta = - E_X$ and the last term disappears; that is, the subsidy is equal to the marginal external benefit from local X production. With full internalization, liberalization of trade in services yields the same types of benefits as when there was no externality. For our small country with no distortions in other sectors, liberalization must raise welfare (if there were distortions in other sectors, the same issues discussed above would arise; the point here is that, with fully internalized externalities, there is nothing really new to worry about).

However, if there is no subsidy in place, then if services trade liberalization lowers domestic production of X, we have $dX^H < 0$, and the losses due to reduced Home production must be weighed against standard gains from trade. On the other hand, if domestic provision is excessively subsidized, free trade will lead to a benefit by undermining the government's subsidy program and reducing the (excessive) scale of domestic production.

Trade liberalization under the national treatment rule

In the discussion of externalities above, I showed that, as long as externalities are fully internalized, they create no problems for trade liberalization. Trade protection is an inefficient instrument to deal with externalities, as long as governments implement policies that fully internalize externalities.

However, when there are externalities, care must be taken in defining the terms under which trade liberalization occurs. Granting national treatment status to foreign service providers would be a mistake in such circumstances, if national treatment required that any subsidies made available to local service providers were also made available to foreign providers who sold services in the Home country (in any of the modes of delivery).

To simplify, maintain the assumptions above and let us suppose that quota rents accrue to foreigners. Then, if the subsidy θ applies both to local and foreign providers who sell locally, the effects of trade liberalization are given by:

$$E_u\, du = -M_X dp_X - (\theta + E_X) dX^H - \theta dM_X - M_X d\theta.$$

If the subsidy initially fully internalizes the externality, then a small amount of imports will reduce welfare. That is, starting from $M_X = 0$, and $\theta = -E_X$, we have

$$E_u\, du = -\theta dM_X < 0.$$

This is because part of the subsidy payment accrues to foreigners but does not yield any external benefits. For positive levels of imports, this effect has to be balanced against the direct gains from trade. To mitigate the subsidy leakage, the government may reduce the subsidy ($d\theta < 0$), but then full internalization will no longer be achieved and again a welfare improvement cannot be assured.

For an even more striking result, consider the effect of allowing free trade in services, but under a national treatment rule that applies to subsidies. Because there is free trade, there are no quota rents to worry about. Also, because the subsidy must be available to both local and foreign service providers, it is equivalent to a domestic consumption subsidy. Since the Home country is small in our example, the free trade price of services in the absence of any subsidy is just the foreign price, p_X^*. Now suppose we start out in free trade, and the Home government tries to internalize the effect of the externality under the national treatment rule. Consider the effect of the subsidy on consumption. The consumer price falls to $p_X^* - \theta$, and so domestic consumption goes up. Note that the positive externality arose from local consumption of the local service, not from consumption *per se*.

What about the effect of the subsidy on local output? Producers respond to the producer price, not the consumer price. Because of free trade, the producer price will remain fixed at p_X^*, and thus there will be no effect on the level of domestic output. That is, by liberalizing trade under a national treatment rule that applies to subsidies, the government loses its ability to internalize the externality. It is easy to show that, in such a scenario, trade can be welfare-reducing. This is illustrated in the figure below:

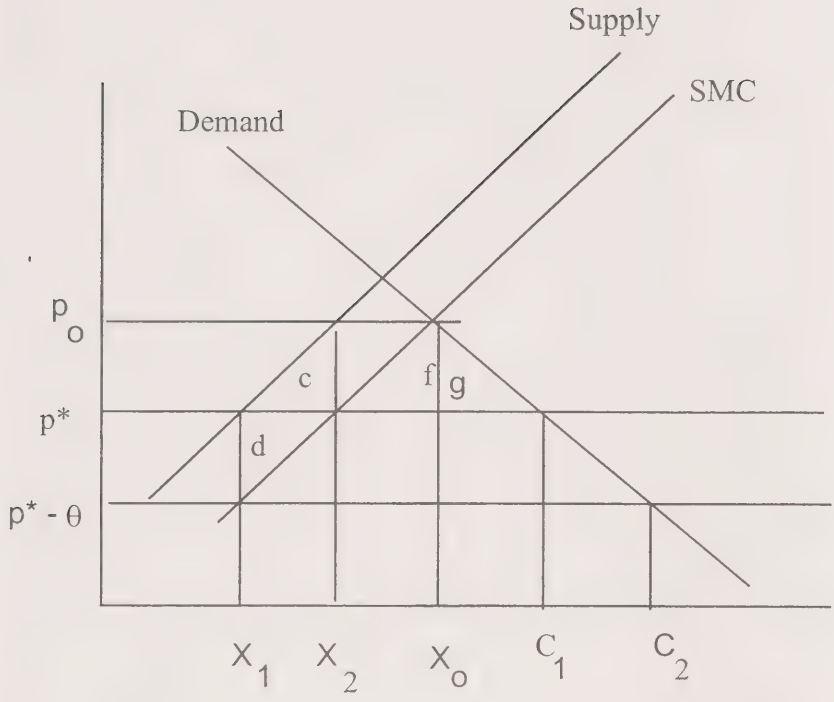


Figure 1: A Case of Welfare Reduction from Trade

I capture the external benefit from domestic consumption of the local service as the gap between the domestic supply curve and the "social marginal cost" curve (SMC). Initially, without trade, the government fully internalizes the externality by subsidizing domestic production. Price is p_o and output is X_o. Since the world price p* is below the domestic price, there are potential gains from trade. If the government allows free trade in services, but retains the right to offer a subsidy to domestic producers, but not foreigners, then the consumer price falls to p*, domestic output falls to X_2, and consumption rises to C_1. There are standard gains from trade given by the area f+g. As noted above, free trade is beneficial, provided that the government is able to offer a discriminatory subsidy to the domestic firm.

Suppose, however, that the government agrees to a national treatment rule that requires that foreign suppliers receive the same subsidy as the local producers. First note that, if there is no subsidy, Home output is at X_1, and consumption is C_1, with the balance being imported. Now suppose the government provides a subsidy θ per unit output to the domestic firm only. This shifts out the domestic supply curve to SMC, and increases output to X_2, as desired. However, if the subsidy must also be offered to foreign service providers, then the (perfectly elastic) foreign supply curve shifts down to $p^* - \theta$, which reduces Home output back to X_1. Consumption does rise to C_2, but the increased consumption induced by the subsidy is all provided by foreigners. Consequently, the attempt to internalize the externality is fully thwarted by the national treatment rule.

Since there is no point in introducing a subsidy in this situation, the gains from trade under the national treatment rule are f+g - (c+d), which will be negative, if the externality is sufficiently important.

It is important to emphasize that this analysis is not an argument against trade liberalization. As noted above, the first-best policy for this country is free trade combined with internalization of the externality. Rather, the point of this analysis is that careful consideration must be given to the rules under which a liberal trading regime operates. For some types of industries, there are no externalities, and a national treatment rule may be a useful part of the framework of a trade agreement. However, for other types of industries, this type of rule is inappropriate, because it eliminates the flexibility of the government to deal efficiently with internal domestic policy concerns.

Regulation with negative externalities

I now provide only a very stylized illustrative example to illustrate some of the issues that emerge when there are *negative* externalities. The purpose of this exercise is to illustrate the interaction between services trade liberalization, when there is a motive for regulation and regulation is endogenous.

Suppose Home has N consumers, and each consumes a fixed amount $\underline{C}$ units of a service and spends whatever income is left over on a numeraire consumption good. The numeraire good is produced only from labour, and there are L units of labour in total. The service is produced from labour and a specific factor K_S.

Suppose that provision of the service can cause some harm to consumers, and, for simplicity, treat the harm as a negative externality.[33] I do not model the harm-generating process explicitly, but rather assume that harm per unit service consumed can be reduced by regulation, which one might think of as inspection and monitoring services.

For a domestically produced service, let H(R) be the per capita harm per unit service, where H is decreasing in R, and $H'(R) > 0$, so that increased regulation reduces harm at a decreasing rate. For a service from a foreign service provider from country z, the harm will depend on the foreign regulatory regime $R^*(z)$, additional domestic regulatory services applied to the foreign provider $R^M(z)$, and possibly increased enforcement costs when dealing with a provider from a foreign country. So denote the harm per unit service from a foreign provider as $H^*[R^*(z),R^M(z),z]$.

All domestic agents are identical, and the utility of a typical consumer is given by

$$U = V(p,I) - H(R)C - H^*[R^*(z),R^M(z),z]M,$$

where M denotes "imports" of foreign services, which may come from any of the four different modes of supply and $C + M = \underline{C}$. I assume that the service provider must pay for the regulatory services.

[33] In many cases, the most appropriate modelling approach would be to explicitly model information and reputation problems, but this approach is left for future work. However, in many cases, externalities are relevant. Transportation services can cause accidents; medical errors may be costly to the general public when there is public insurance, and also may have public health repercussions; education services generate externalities; faulty construction practices can have impacts on those who did not purchase the services directly, and recourse via the courts may be costly.

The profit function for the local sector is given by

$$\pi(p - wR, w, K_S),$$

and so, if we normalize N to 1, national income is

$$I = wL + \pi(p - wR, w, K_S) + \lambda(p - p^*)M$$

where λ is the fraction of the quota rents accruing to the domestic economy.

A benevolent domestic regulator chooses R to maximize U. Suppose that the regulator treats M and p^* as given. Then, maximizing U subject to I yields

$$-H_R C = wC + (1 - \lambda)\frac{dp}{dR} M$$

The marginal benefit of increased regulation (harm reduction) is set equal to the marginal cost (increased regulatory costs) plus increased import costs due to the regulation-induced increase in the domestic price of services.

To avoid rent-shifting motives for regulation, I suppose $\lambda = 1$, so that Home gets the quota rents. Then, treating p^*, R^* and R^M as given, the welfare effects of allowing increased market access to foreigners are given by:

$$\frac{dU}{dM} = V_I(p - p^*) - (H^* - H)$$

Increased market access for foreign service providers has two effects on welfare. First, there are standard gains from trade, if foreigners can provide the service at a lower cost than domestic residents. Second, however, is the average harm effect. There are two possibilities.

First if $H^* < H$, then the foreign service providers on average have less harmful side effects than domestic providers. Foreigners provide a service that is both low-cost and high-quality. In this case, Home unambiguously gains from allowing foreign access to the local market. As well as standard gains from trade, Home saves on regulatory costs.

Second, if $H^* > H$, then foreign service providers are less well-regulated than Home providers, and average harm rises with increased market access.

One of the implications of this analysis is that Home can gain by granting unconditional access to its market to all those foreign suppliers with $H^* \leq H$. Bilateral agreements for market access would be welfare-improving, since governments could determine which countries have standards at least as high as Home's. However, multilateral agreements become problematic, unless a means can be found to either exclude suppliers from countries z with $H^*(z) > H$, or to subject such firms to increased regulatory scrutiny.

Home can guarantee a welfare improvement from granting foreign access, if it chooses $R^M(z)$, so that

$$H = H^*[R^*(z), R^M(z), z].$$

Then, a competitive foreign firm from country z will pass the regulatory costs onto consumers, and so its price will be $p^* + wR^M(z)$. Foreign firms will enter the Home market only if $p^* + wR^M(z) < p$. The welfare effects of granting such a firm access to the local market is then:[34]

$$\frac{dU}{dM} = V_I[p - p^* - wR^M(z)] \varepsilon 0.$$

That is, if governments have full power to regulate foreign service suppliers, and the cost of this regulation is internalized in the price charged, then granting access to foreign suppliers will improve welfare. However, notice that the regulatory intensity will be different for service providers from different countries. Suppliers from countries with weak regulatory systems will be more intensely regulated locally. As well, Home may have more difficulty enforcing regulations for suppliers from some countries than others, and this also will then tend to push up regulatory costs for firms from such countries.

---

[34] This may not, however, be the socially optimal choice of R^M — it is possible that different levels of harm from different suppliers may be efficient.

Because regulatory intensity must vary with the supplier's country of origin, implementing a national treatment regime may be problematic. If H* is easily observable, then national treatment would simply involve enforcing a common H. However, in most cases, H is not observable.

If H is hard to measure, countries may be forced to regulate the process by which services are produced. This may require that service providers be certified, and so on. National treatment in this case would then mean that domestic and foreign providers meet the same standards. Such a rule, however, if applied uniformly, could negate some of the gains from trade. Suppliers from low H* countries may not meet exactly the same standards as local producers, but may well provide a superior service. It would make sense then to exempt some suppliers from domestic certification standards, but to require it of others.

Further discussion of the implications of this issue appears in the text of the paper.

A3. Trade and investment liberalization in the services sector: Models with product variety

Introduction

In this section, I work through a simple product-differentiation model to illustrate how each of the four different models of supply can lead to gains from liberalization of restrictions on foreign service providers. The model is based on Krugman (1980), Markusen (1984) and Brainard (1993), and is somewhat influenced by Markusen and Venables (2000). It is closest in approach to Brainard, but is extended to allow for different modes of supply, as well as to focus on issues, such as the implications of more than one service sector, and the effect of services trade liberalization on emigration incentives. On the other hand, it is somewhat simpler than Brainard or Markusen and Venables, since the mode of supply is treated here as exogenous for simplicity.

Consumers have preferences defined over both goods and services. There is one consumption good, Z; and there are one or more service sectors. Consumers have a taste for variety within each service sector.

For simplicity, suppose there are two service sectors X and Y. Utility is:

$$U(Z,X,Y) = X^{\delta_x} Y^{\delta_y} Z^{\upsilon} \tag{1}$$

where $\delta_i \varepsilon 0$, $\nu > 0$, and $\delta_X + \delta_Y + \nu = 1$, and where:

$$X = \left(\sum_{i=1}^{n_x} x_i^{\rho_x} \right)^{1/\rho_x} . \tag{2}$$

and:

$$Y = \left(\sum_{i=1}^{n_y} y_i^{\rho_y} \right)^{1/\rho_y} . \tag{2}$$

where $0 < \rho_X < 1$ and $0 < \rho_Y < 1$.

There are two primary factors, labour (L), and capital specific to services (K_S). "Capital" can be interpreted broadly to include human capital.

I assume that good Z is produced only from labour, with a unit labour requirement of 1. Moreover, I assume that technology is identical across countries and that demand for Z is large enough, so that both countries always produce Z in any free trade or investment equilibrium. This is a major simplifying assumption that facilitates the exposition; the implications of relaxing it will be discussed later. Letting Z be the numeraire, this then fixes the wage at $w = 1$ in both countries. It does not, however, force full factor price equalization, as the returns to specific factors in services will vary across countries.

Services are produced from labour and service capital. To avoid duplication in the exposition, I will focus on the X service; the Y sector is set up analogously. There are both fixed and variable costs in service production. I assume that each

variety in the X sector requires γ_X units of service capital as a set-up cost. If more than one plant is desired, there are extra fixed costs to be discussed later. Finally, each additional unit of service produced requires α_X units of labour. For a firm with only one plant, producing x_i units of service i, total costs are:

$$C^i(x_i) = r\gamma_X + w\alpha_X x^i. \tag{4}$$

Because of fixed costs and the structure of preferences, each firm will produce a unique variety. Because of the symmetry, all firms in the same country will charge the same price.

Let p_{Xi} be the price of service i in sector x. Then, because of the structure of preferences, consumers can do two-stage budgeting; so that we can think of consumers choosing X using the following price index Q_X for X:

$$Q_x = \left[\sum_{i=1}^{n_x} p_{xi}^{1-\sigma_x} \right]^{\frac{1}{1-\sigma_x}} \tag{5}$$

where $\sigma_X + 1/(1-\rho_X)$. The demand for variety i is:

$$x_i = \frac{\delta_x Q_x^{(\sigma_x - 1)}}{p_{xi}^{\sigma_x}} I \tag{6}$$

where I is income.

Because of symmetry, all firms will charge the same price and produce the same quantity of output, so I will drop the subscript i. Firms are assumed to treat I and Q_X as given, and thus the elasticity of their demand curve is σ_X. Profits of a typical firm with only one plant are:

$$\pi_X = (p_X - w\alpha_X)x - r\gamma_X. \qquad 1 \tag{7}$$

Profit maximization leads to the pricing rule:

$$p_X = \frac{\sigma_X}{\sigma_X - 1} w\alpha_X. \tag{8}$$

Free entry implies that profits are zero, which yields an expression for output:

$$x = \frac{F_X(\sigma_X - 1)}{w\alpha_X}, \tag{9}$$

where $F_X = \gamma_X r$.

Since all firms charge the same price, (5) reduces to:

$$Q_x = n_x^{\frac{1}{1-\sigma}} p_x \tag{11}$$

so that the price index is decreasing in the number of varieties, and (6) reduces to:

$$x = \frac{\delta_x I}{p_x n_x} \tag{12}$$

No trade or foreign investment in the services sector

If there is no trade or investment in services, then market clearing requires that demand and supply for each variety be equated; hence from (6) and (9) we have:

$$\frac{\delta_x I}{p_x n_x} = \frac{F_x(\sigma_x - 1)}{w\alpha_x} \tag{13}$$

Using (8), this can be simplified to:

$$\frac{\delta_x I}{\sigma_x} = n_x \gamma_x r \tag{14}$$

Using the same approach, we obtain for sector y:

$$\frac{\delta_y I}{\sigma_y} = n_y \gamma_y r \tag{14a}$$

Summing (14) and (15) yields:

$$\left(\frac{\delta_x}{\sigma_x} + \frac{\delta_y}{\sigma_y}\right) I = n_x \gamma_x r + n_y \gamma_y r = r K_s \tag{15}$$

Note that we have used the full employment condition for capital here. Income is:

$$I = wL + r_s K_s \tag{16}$$

and so, using (14) and (15), we can solve for r_s:

$$r_s = \frac{\left[\frac{\delta_x}{\sigma_x} + \frac{\delta_y}{\sigma_y}\right] wL}{\left[1 - \left(\frac{\delta_x}{\sigma_x} + \frac{\delta_y}{\sigma_y}\right)\right] K} \tag{16}$$

Output per firm in sectors x and y is:

$$x = \frac{r_s \gamma_x (\sigma_x - 1)}{w \alpha_x}, \quad y = \frac{r_s \gamma_y (\sigma_y - 1)}{w \alpha_y} \tag{17}$$

Also, the number of firms in sector j is:

$$n_j = \frac{\delta_j \ I}{\sigma_j \gamma_j r}, \qquad j = x, y \tag{18}$$

which can be simplified to:

$$n_j = \frac{K}{\gamma_j} \left[\frac{\frac{\delta_j}{\sigma_j}}{\frac{\delta_x}{\sigma_x} + \frac{\delta_y}{\sigma_y}} \right], \qquad j = x, y \tag{18a}$$

Increasing country size with K/L constant leads to a larger variety of both types of services. This, in turn, reduces the price indexes Q_x and Q_y, and increases welfare. The nominal return to capital is unaffected by country size.

As one would expect, countries relatively scarce in service capital have higher returns to capital, r. This results in a relative scarcity of services, a higher price index Q, and a higher output per firm.

Let us now suppose that there is free trade in the X service, but not the Y service. With no trade impediments in X, all consumers in both countries will consume all varieties of X. Because wages are equal across countries, the price of a variety in either country will still be determined by (8). The price index Q_X, therefore, becomes:

$$Q_x = \left(n_x + n_x^*\right)^{\frac{1}{1-\sigma}} p_x \tag{19}$$

Although p_X is unchanged by trade, the price index for X services, Q_X, falls, as long as consumers have access to a wider variety of services than prior to services trade liberalization.

The demand for a given variety now reflects both domestic and foreign income, as well as the new price index. Hence (12) becomes:

$$x = \frac{\delta_x \left(I + I^*\right)}{p_x\left(n_x + n_x^*\right)} \tag{20}$$

Assume, at first, that X is produced in both countries. Then, free entry at Home requires (9), which in free trade becomes:

$$\frac{\delta_x \left(I + I^*\right)}{\sigma_x\left(n_x + n_x^*\right)} = r\gamma_x \tag{21}$$

Similarly, free entry in Foreign requires:

$$\frac{\delta_x \left(I + I^*\right)}{\sigma_x\left(n_x + n_v^*\right)} = r^*\gamma_x, \tag{22}$$

Comparing (12) and (13), we see that free trade ensures that the return to service capital is equated across countries ($r = r^*$).

Trade in services will change the equilibrium number of varieties of both X and Y produced in each country. Because there is no trade in Y, the number of varieties produced is determined by the free-entry condition (14) and its foreign analogue—demand in each case reflects only local demand conditions. Combining these conditions for the two countries, and noting that $r = r^*$, we obtain:

$$\frac{\delta_y (I + I^*)}{\sigma_y \left(n_y + n_y^*\right)} = r\gamma_y, \tag{23}$$

Combining (21) and (23), and using the definitions of income, we can solve for the returns to capital and the equilibrium number of X varieties:

$$r_s = \frac{\left[\frac{\delta_x}{\sigma_x} + \frac{\delta_y}{\sigma_y}\right] w(L + L^*)}{\left[1 - \left(\frac{\delta_x}{\sigma_x} + \frac{\delta_y}{\sigma_y}\right)\right](K + K^*)} \tag{24}$$

and:

$$n_x + n_x^* = \frac{(K + K^*)}{\gamma_x}\left[\frac{\frac{\delta_x}{\sigma_x}}{\frac{\delta_x}{\sigma_x} + \frac{\delta_y}{\sigma_y}}\right] \tag{25}$$

Using (18), the number of Y varieties is:

$$n_y = \frac{\delta_y}{\sigma_y \gamma_y}\left(\frac{w}{r}L + K\right), \qquad n_y^* = \frac{\delta_y}{\sigma_y \gamma_y}\left(\frac{w}{r}L^* + K^*\right) \tag{26}$$

The expression in (26) depends or r, which is endogenous, but a closed form can be obtained by employing (24). However, (26) will be useful to help us to make some inferences about the effects of trade.

First, suppose the two countries are completely identical. Then, the world and local capital/labour ratios are the same, and from (24) we see that trade has no effect on the return to service capital, nor does it affect outputs of x varieties. As well, from (26) since r does not change, there is no effect on the Y sector. In this case, the sole effect of trade liberalization in the X service sector is to expand the number of varieties of X services available to consumers: comparing (25) and (18), the number of varieties available to consumers is twice what it was prior to free trade. This lowers the price index Q_X, and this

unambiguously leads to a Pareto improvement—all workers and capitalists gain from access to a wider variety of services.

A similar result is obtained, if Home and Foreign have the same relative factor endowments ($K/L = K^*/L^*$). Then, as long as the X sector survives in both countries, the only effect of trade is to allow consumers in each country access to a wider variety of choices. In this case, however, the smaller country gains more from trade in services than the larger country. Because a small country has a small market, choice there is initially more limited than in the large country. Trade, therefore, leads to a greater expansion of choice in the small country. Put another way, the price index Q_X falls by more in the small country than in the large country, because it was initially relatively higher in the small country.

Now, suppose that Home is relatively abundant in service capital. From (16), we see that the return to service capital was initially lower in the Home country than in the foreign country. Foreign's higher pre-liberalization return to service capital reflects its relative scarcity there.

Comparing (16) and (25), we see that the convergence of capital returns induced by trade increases the return to capital at Home and reduces it in Foreign. Trade both increases market opportunities for services capitalists, but also increases competition. If the two countries are identical, then these two effects fully offset each other. However, for the capital-scarce country, the increased competition effect dominates the market access effect, and their return falls. This need not mean that foreign capitalists are worse off, however, since we also need to consider the effect of the changes in the service price indexes.

From (25), we note that both countries enjoy access to a greater variety of X services, and thus the price index for X services falls in both countries.

However, from (26), we see that the effects on variety in the Y sector differ across countries. Since r falls in Foreign, n^* rises, and thus the price index for both X and Y services falls in the capital-scarce country. In the capital-abundant country (Home), however, the Y service sector is squeezed by liberalization in X. Trade liberalization in X increases market access for capitalists in the X sector, and this induces movement

out of Y and into X. Consequently, the price index for Y services rises at Home and falls in Foreign as a result of liberalization in X.

Specialized trading equilibrium

Using (26) and (24), solving for n_y, and using the full employment condition for capital yields an expression for the equilibrium number of X varieties produced in a country after trade liberalization. For Home we have:

$$n_x = \frac{L}{\gamma_x}\left[\frac{K}{L}\left(1-\frac{\delta_y}{\sigma_y}\right)-\frac{\delta_y}{\sigma_y}\frac{K^w}{L^w}\left(\frac{1-\left(\frac{\delta_x}{\sigma_x}+\frac{\delta_y}{\sigma_y}\right)}{\frac{\delta_x}{\sigma_x}+\frac{\delta_y}{\sigma_y}}\right)\right], \qquad (27)$$

Notice that n_x is decreasing in the K/L ratio. That is, controlling for size (holding L constant), countries relatively less endowed in capital produce fewer varieties of X. Trade in services allows such a country to expand its output of the other service Y, by importing more X.

Moreover, note that, if K/L is sufficiently small relative to the rest of the world, then Home's X industry shuts down, when service trade liberalization occurs. That is, for sufficiently low K/L relative to the rest of the world, (27) would imply that $n_x < 0$. This simply indicates that, in fact, $n_x = 0$. In this case, the price equalization result no longer applies, but we obtain qualitatively similar effects from trade. Although the local X industry collapses, the X industry in Foreign expands, and its output is available to Home consumers via trade. Home consumers, therefore, gain access to a greater variety of both X and Y services.

Piecemeal liberalization as a partial cure for the brain drain

The benefits of trade liberalization may in fact be larger than indicated here, if we take into account the possibility of

migration. Suppose that capitalists are potentially mobile across countries. Suppose also that capitalists differ in their allegiance to their country of origin. Specifically, let us focus on the Home country, and suppose it is small relative to Foreign. For simplicity, ignore Foreign migration (although this wouldn't qualitatively change the result). Suppose Home capitalists are indexed by m = [1,K], and that their utility functions are slightly modified to be as follows:

$$U(Z,X,Y;m) = X^{\delta_x} Y^{\delta_y} Z^{\upsilon} \varphi(m) \tag{28}$$

We suppose that φ(m) = 1 for all capitalists, if they move to the foreign country. However, capitalists living at Home obtain the extra boost to their utility φ. That is, if m prefers to live at Home, all else being equal, then φ(m) > 1, but, if there is no preference for Home, then φ > 1. We order capitalists so that φ' > 0, and suppose that φ(0) ≤ 1 and that φ(K) >>1.

Let us now find the utility of a capitalist in the absence of trade. Using the utility function and the equilibrium conditions, we can solve for consumption to obtain the ratio of utility of a Home capitalist who moves to Foreign relative to the utility he or she would obtain by staying at Home. Let U^e denote the utility of an emigrant. Then:

$$\frac{U^e}{U} = \frac{(n_x^*)^{\delta_x/(\sigma_x-1)}(n_y^*)^{\delta_y/(\sigma_y-1)} r*}{(n_x)^{\delta_x/(\sigma_x-1)}(n_y)^{\delta_y/(\sigma_y-1)} r\varphi(m)} \tag{29}$$

That is, the relative benefits of emigrating versus staying at Home depends on the income differential, the difference in the variety of services available in the two countries, and the Home preference.

Since larger countries have a greater variety of services available in the absence of trade, then one would expect that capitalists with a weak attachment to their homeland would be tempted to move. This is indeed the case. Using our solutions for the number of varieties produced in Home and Foreign prior to trade, we obtain:

$$\frac{U^e}{U} = \frac{1}{\varphi(m)}\left(\frac{L^*/K^*}{L/K}\right)\left(\frac{K^*}{K}\right)^{[\delta_x/(\sigma_x-1)]+[\delta_y/(\sigma_y-1)]} \quad (30)$$

If there is no Home preference ($\varphi = 1$) and if the relative factor abundance is the same across countries, then utility is higher in the larger (Foreign) country and thus there is an incentive for low φ people to move. This incentive is moderated somewhat if capitalists are in relatively scarce supply at Home, since then their income is higher at Home, and this may partially compensate for the relatively low variety of services available.

Consider two countries with the same capital/labour ratio. Then, we obtain a simple downward sloping relation between U^e/U and m. Prior to trade, all capitalists $m < m_0$ would like to emigrate at the initial equilibrium.[35] Moreover, this emigration, if it occurred, would be harmful to the workers at Home. If a worker has one unit of labour, and with the wage equal to 1 from the goods market equilibrium, the utility of a typical Home worker is given by:

$$U^L = aK^{[\delta_x/(\sigma_x-1)]+[\delta_y/(\sigma_y-1)]} \quad (31)$$

where $a > 0$ is a constant. Any emigration of capitalists leads to an erosion of product variety in the services sector, raising the price index for services and lowering worker utility.

Finally, worker utility in the Foreign country is given by:

$$U^{*L} = aK^{*[\delta_x/(\sigma_x-1)]+[\delta_y/(\sigma_y-1)]} \quad (32)$$

Foreign workers gain, if their country is successful in attracting capitalists from Home, since this raises K*, thereby raising product variety. If workers are in the majority and if immigration policy were heavily influenced by majority voting, then one would expect that the Foreign country would be receptive to immigration of capitalists from other countries. Finally, note that increases in the supply of labour have no effect on worker utility in this model. If, however, there were any assimilation costs that were partially borne by the country

[35] Note however, that as movement occurs, the relative utilities will endogenously change. So if movement actually occurs, the equilibrium cut-off will be different than m_0.

receiving immigrants, then one might expect that there would not be similar majority support for immigration of workers.

Consequently, the no-service-trade equilibrium is likely to lead to a "brain drain" from the Home country. Some capitalists in the Home country have an incentive to move to the Foreign country, and, moreover, the Foreign country is likely to be receptive to their move. Those Home workers with weak attachments to their homeland would also want to move, but they would be less likely to be accepted by the Foreign country. This means that Home workers will tend to be hurt by the out-migration of capitalists.

Now consider the effect of trade liberalization in the X service sector. For clarity, suppose that the capital/labour ratio is initially the same between Home and Foreign. Then, in the equilibrium with free trade in X (but no trade in Y), the utility differential for capitalists is:

$$\frac{U^e}{U} = \frac{1}{\varphi(m)}\left(\frac{K^*}{K}\right)^{\delta_y/(\sigma_y-1)} \tag{33}$$

Trade in X will equalize the variety of X services available across both countries, and this will reduce the incentive for capitalists to emigrate. There is still a wider variety of Y services available in the Foreign country, and this will continue to provide an attractive beacon for the more restless capitalists. Trade liberalization in X shifts the utility differential relationship to the left, and reduces the range of capitalists who want to move.

Finally, consider the effects of full trade liberalization in both X and Y. Then we have:

$$\frac{U^e}{U} = \frac{1}{\varphi(m)} \tag{34}$$

With full trade liberalization, the only capitalists who want to move are those who would prefer to live in the Foreign country, even if their real income were the same as at Home. That is, full trade liberalization eliminates the incentive for economically induced migration. Moreover, in this case, workers don't really care if migration occurs anyway, since they have access to the full range of services via trade.

However, because of the special nature of many services, requiring personal contact between the seller and the buyer, there will always be some service sectors in which full trade liberalization is not technologically feasible. Consequently, if we think of partial liberalization as the most relevant scenario, then potential emigration will remain a problem, but piecemeal service trade liberalization can provide a useful partial remedy.

Other modes of delivery

Now suppose that it is not feasible to trade services because of technological constraints. That is, suppose that some direct contact between the client and service provider is required.

Because services are a differentiated product, consumers in each country would have a latent demand for the services produced in other countries. Service providers have three options available to them, if a direct contact is required with the client. The client can come to the service provider, the service provider can send personnel to service the client, or the service provider can set up a branch office and hire local personnel to service local clients. Some combination of all three is possible as well, but I will focus on each of the three separately to facilitate a comparison

Client comes to service provider

One possibility is that the customer travels to the producing country to obtain the service (e.g., a foreign vacation, medical services, education services and many business services can be purchased via a visit to the country that produces these services). We can model this by introducing a fixed cost of consuming a foreign product. This fixed cost may include travel costs, information costs and possibly costs of adapting the service to local needs (if, for example, regulations in the Home country fail to recognize the validity of the foreign service). It is possible that, once paying this cost, a consumer can consume a package of foreign services; however, for simplicity, I will assume that the fixed cost must be borne for each different variety of service consumed.

Consider a typical Home consumer. For simplicity, suppose there is only one service sector x, so that $\delta_y = 0$. Suppose a fixed consumption cost F_c is required for each Foreign variety consumed. Then, if there are n Home services, a consumer with income I^k who consumes n^f Foreign services enjoys a utility of:

$$U = \frac{\delta_x^{\delta_x}(1-\delta_x)^{1-\delta_x}}{p_x^{\delta_x}}\left[I^k - n^f F_c\right](n+n^f)^{\delta_x/(\sigma_x-1)} \tag{35}$$

We suppose all producers treat n^f as given, so that they employ the same mark-up rule as before given by (8).[36] Hence p_x is the same across countries because of our equal wage assumption. Choosing n^f to maximize utility yields (for an interior solution):

$$\frac{\delta_x}{(\sigma_x-1)(n+n^f)} = \frac{F_c}{I^k - n^f F_c} \tag{36}$$

The consumer weighs the marginal benefit of more variety against the marginal loss due to paying more fixed costs. The solution is illustrated in Figure 2 (for the case of an interior solution). Solving yields:

$$n^f = \frac{\delta_x I^k - nF_c(\sigma_x - 1)}{(\delta_x + \sigma_x - 1)F_c}. \tag{36}$$

Notice that, if the fixed cost is sufficiently high, there will be no consumption of Foreign varieties. More domestic choice (higher n) also deters Foreign consumption. Higher income, on the other hand, encourages Foreign consumption. This implies that, if income is not uniformly distributed, then higher income people will allocate a larger fraction of their budget to consuming foreign varieties. Richer people will be better off both because they have more purchasing power, but also because they can afford to buy into foreign service consumption networks.

---

[36] We can think of the consumer first paying the fixed cost and then deciding which variety to consume once he or she is in the foreign county. Thus, no individual producer can increase market share by trying to induce more foreigners to pay the fixed cost.

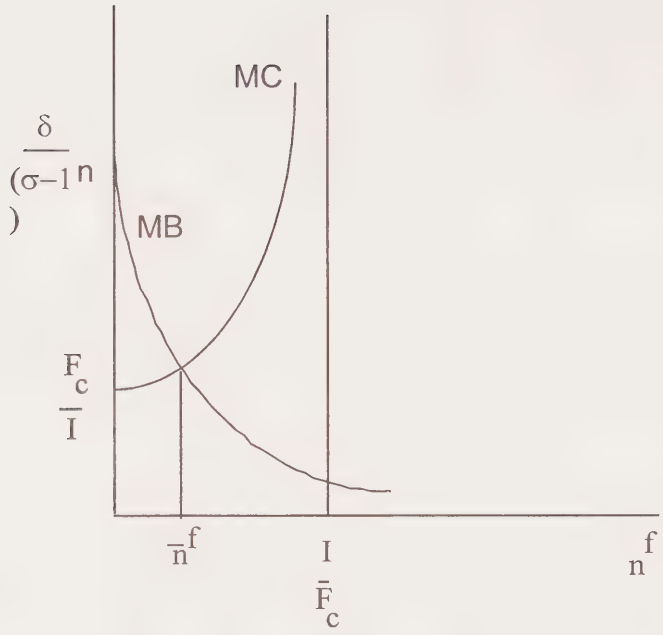


Figure 2. Optimal choice of foreign variety consumption in the presence of fixed consumption costs

For simplicity, let us consider two identical countries, and suppose that each country has L agents who each have 1 unit of labour and an equal share of the capital. Consequently, we will obtain a symmetric equilibrium. Free entry will imply:

$$\left(\frac{I - n^f LF_c}{n + n^f}\right)\left(1 + \frac{n^f}{n}\right) = \frac{\sigma_x r \gamma_x}{\delta_x} \tag{37}$$

The domestic and foreign markets are symmetric, but a typical Home firm gets, on average, only a fraction n^f/n of the Foreign customers. Simplifying yields:

$$n^f = \frac{wL - rK(\sigma_x - \delta_x)/\delta_x}{LF_c} \tag{38}$$

If all consumers are identical, we can write (36) as:

$$n^f = \frac{\delta_x(wL + rK)/F_c - nL(\sigma_x - 1)}{L(\delta_x + \sigma_x - 1)} \qquad (39)$$

Equations (38) and (39) give us two equations that determine r and n^f (for interior solutions). They are illustrated in Figure 3.

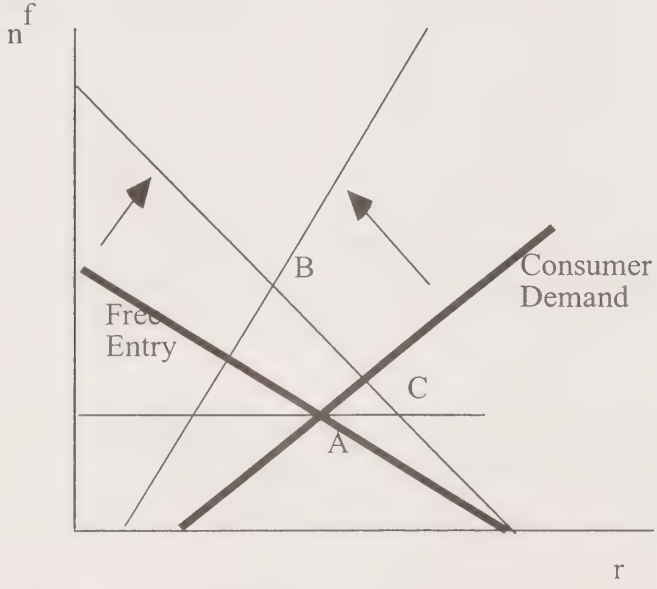


Figure 3. Effect of a decrease in fixed costs to consumers of accessing foreign markets

The free entry condition slopes downward, since an increase in n^f means that consumers are allocating more of their income to fixed costs, leaving less to spend on services, and therefore reducing profits (and hence lowering r). The consumer demand condition slopes up, since an increase in r corresponds to an increase in income per capita, which raises the number of varieties for which consumers are willing to travel to the foreign country. The initial equilibrium is at point A.

Let us now consider services trade liberalization that lowers the costs to consumers of accessing foreign markets. This could correspond to a reduction in travel costs (which in itself could be due to services trade liberalization, or to a commitment to recognize the foreign service as satisfying local requirements. We capture this with a fall in the fixed costs of accessing foreign services, F_c. If the initial equilibrium is at A, a fall in F_c shifts out the free-entry condition and shifts up the consumer-demand condition. The net effect is that the number of foreign varieties accessed by local consumers (n^f) rises. A reduction in protection does, however, reduce the return to capital in this symmetric case.

To find the net effect of a fall in F_c on a typical consumer, refer to (35). By the envelope theorem, the effect of a fall in F_c on consumer welfare depends on its effect on $I^k - n^f F_c$, holding n^f constant. Since all consumers are identical, this is equivalent to the effect on $I - Ln^f F_c$. However, from (37), we have:

$$I - n^f LF_c = \frac{K\sigma_x r}{\delta_x} \tag{40}$$

that is, in fact, the condition traced out by the free-entry condition (38) in Figure 3. Hence $I - Ln^f F_c$ is proportional to r for any n^f. However, as F_c falls, the free-entry condition rotates out leading to a new equilibrium at B, at which the return to capital is lower. However, at the original n^f, we obtain point C on the new free-entry curve, which is to the right of the original point A. Hence, we conclude that consumer welfare rises as F_c falls. Consumers gain from saving on access costs to foreign products, and, as a consequence of easier access, they gain from increased variety in their consumption portfolio.

This type of services trade liberalization is likely to enjoy widespread support in the host country, since it leads to an increase in employment as more local service providers sell to foreign customers; that is, there is a market-expansion effect. If we introduced an upward sloping supply of labour (for example, by introducing a fixed factor into goods production), then a country that unilaterally allowed increased access by foreigners would see an increase in the demand for its products and its

labour, which would tend to lead to wage increases and therefore widespread support for such a policy.

Opposition might come from those service providers in the domestic market that lose some of their customer base—that is, while they might expect to attract new foreign customers, they may tend to focus on the local customers that they are losing. In cases of relatively small markets, there would be a relatively larger exodus of local customers because of the smaller product mix at Home—it is possible to obtain asymmetric equilibria where consumers from the small country visit the large country for services, but not vice versa.

Foreign service provider comes to client

In many cases, it is not possible for the client to come to the service provider. For many services, an on-site presence by the provider may be required. For example, a plumbing problem can be solved if the plumber comes to the site, but the site cannot be brought to the plumber. Many producer services also have this feature.

Let us suppose that a service provider in the Home country desires to service a client in the foreign country by providing an on-site service. Then, the firm must send one or more workers to the foreign country. We suppose that this type of transaction is costly (since the worker has to travel and may be subject to local regulations; it is also possible that there might be a requirement that a local provider be present to ensure domestic regulations are adhered to). To capture this simply, we suppose that the cost of sending a worker to a foreign country to provide a unit service is $\lambda \alpha w$, where $\lambda > 1$. We assume that the costs are symmetric across countries.

Again, I simplify by assuming $\delta_y = 0$ to focus on the case of just one service sector. I will also once again assume symmetry across countries. If a consumer consumes services from n local firms and n* foreign firms, then the price index is:

$$Q = \left(n + \lambda^{1-\sigma} n^*\right)^{\frac{1}{1-\sigma}} p_x \tag{41}$$

where I have dropped the subscript "x" on most variables.

The free entry condition can be written:

$$\frac{I}{n+n^*\lambda^{1-\sigma}}+\frac{I^*\lambda^{1-\sigma}}{n^*+n\lambda^{1-\sigma}}=\frac{r\gamma\sigma}{\delta} \tag{42}$$

With symmetry across countries, this becomes:

$$I\left(1+\frac{1}{\lambda^{\sigma-1}}\right)=\frac{\sigma Kr\left(1+\lambda^{1-\sigma}\right)}{\delta} \tag{43}$$

With simplifying yields, this becomes:

$$r=\frac{\delta Lw}{K(\sigma-\delta)} \tag{44}$$

That is, the return to capital depends only on the capital/labour ratio and is not affected by trade: because of symmetry, the market-expansion effect is fully offset by the increased competition effect.

The welfare effects of allowing service providers to move between countries can then be inferred from (41). If λ is infinite, then, each country consumes only its own product varieties. If λ is zero, then the free-trade-in-services equilibrium is fully replicated. If λ is positive, then foreign services are relatively more expensive than local services, and this is reflected in the price index—consumers in each country consume relatively more local than foreign services. As λ falls, and foreign service providers can move across the border at lower cost, consumers in both countries gain from access to lower-cost foreign services.

I have focused here on the symmetric equilibrium. If one country is much larger than the other one, then consumers will be better off in the big country, because they have access to a wider variety of local services that do not require incurring the costs of moving personnel across borders. A reduction in λ will improve the welfare of workers in our model, since it leads to a lower price index. However, it will also lead to a relatively large influx of foreign workers into the Home market. In the extreme case, where λ is one, and the two-service sector model of the

previous section is considered, then it is possible for the Home country to specialize in producing the non-tradable service Y, and to rely on foreign workers to provide X services. If the labour supply curve at home is upward sloping, this could put downward pressure on the home wage and generate opposition to liberalization.

Multinational firms

Finally, suppose that neither the customer nor the service provider can move across borders, and that direct services trade is not feasible. Then, the service provider can consider investing in the foreign country.

Suppose that, once a firm has invested in setting up its service variety, it can set up a branch office in a foreign country. A branch office requires a fixed investment, which, for simplicity, we assume requires $b^h\gamma_X$ units of service capital from the source country and $b^f\gamma_X$ units of service capital from the host country. We assume that $b^h + b^f < 1$, so that it is cheaper to set up a branch office than to start a new firm. The idea here is that some supervisory personnel from the source country may be needed to manage the branch office. These might be thought of as temporary movements of skilled workers. As well, it may be necessary to employ local supervisory personnel, since they have knowledge of the local market and local regulations. We assume that marginal costs of service production can all be satisfied with local labour. Consider the free-entry condition for home firms.

Profits of a Home firm with a branch plant are:

$$\pi^{MNE} = px^d + px^f - w\alpha_X x^d - w\alpha_X x^f - r(1+b^h)\gamma_X - r^* b^f \gamma_X$$

where x^d is sales in the home market and x^f is sales in the foreign market.

A multinational will use the same pricing strategy as an exporter, and, thus, using (8), the free-entry condition requires that:

$$\left(\frac{w\alpha_X}{\sigma_X - 1}\right)\left(x^d + x^f\right) = r\left(1 + b^h\right)\gamma_X + r^* b^f \gamma_X \qquad (45)$$

Suppose that all firms have branch plants, and assume symmetry across countries again.[37] Then, the free-entry condition can be written as:

$$\frac{I}{n+n^*}+\frac{I^*}{n^*+n}=\frac{r\left(1+b^h+b^f\right)\gamma_x\sigma}{\delta} \tag{46}$$

Using symmetry again and simplifying yields:

$$r=\frac{\delta Lw}{K(\sigma-\delta)} \tag{47}$$

That is, the return to capital is the same as it was in the trading/ no trade equilibrium. This result is, of course, sensitive to the symmetry assumption.

The equilibrium number of firms is, however, different than in the free-trade equilibrium:

$$n=n^*=\frac{K}{\left(1+b^h+b^f\right)\gamma_x} \tag{48}$$

The increased fixed costs of setting up foreign offices absorbs some of the service capital. This means that the equilibrium number of varieties is less than in a free-trade-in-services equilibrium. However, allowing foreign investment increases the range of varieties available to local consumers in either country relative to the case where there is no other way to access foreign service providers.

Referring to the utility function again, all consumers gain from allowing foreign investment, since it increases product variety. Easing regulations affecting foreign investment, which might be captured here as a reduction in b^h, leads to welfare improvements by further increasing product variety.

In contrast to movement of personnel, this option may generate less local opposition, since it may be viewed as increasing the demand for local labour; and, in a model with an upward sloping labour supply curve, reducing restrictions on foreign investment may lead to an increase in wages.

---

[37] When countries are not symmetric, not all firms will have branch plants.

Although I have focused on the symmetric case here with one service sector, it is worth considering the implications of two services sectors, one without any mode of foreign supply, and also two countries of different size. Let Home be smaller. Then, in equilibrium, the smaller country's market will not be large enough to facilitate investment by all foreign suppliers, and thus product variety at Home will be lower than in Foreign. That is, in equilibrium, some firms will be multinational, and others will not be. However, Home will gain from access to greater product variety due to Foreign investment. Moreover, if we consider the migration model from earlier in the paper, then it should be noted that there will be, as before, an incentive for service personnel in the Home country to migrate to Foreign to take advantage of the larger market. If trade in services is not technically feasible, then it is worth noting that negotiating an agreement to allow mutual temporary movement of service capitalists across borders will be needed to facilitate foreign investment. Such an agreement will increase local product variety and therefore can raise the real income of service capitalists. That is, somewhat paradoxically, a country may be able to prevent an exodus of service capitalists by negotiating an agreement with trading partners to allow temporary movement. Workers gain from this agreement as well, since, by reducing the "brain drain," product variety in non-traded service sectors is maintained or enhanced.

Producer services

Although the model has been set up to treat services as being provided directly to consumers, it is fairly straightforward to adapt it to treat services as an intermediate activity provided to producers. A number of papers in the literature adopt this approach (as discussed in the main text), and here I will just give an indication of how this can generate additional sources of gains from liberalization.

Suppose there are two final consumption "goods" Z_1 and Z_2. Z_2 can be interpreted as either a good or a service. Suppose that Z_1 has the same properties as our old good Z— it uses only labour and is always produced in both countries. Z_2, on the

other hand, uses labour, X services and possibly a specific factor K_2. It has constant returns to scale. For simplicity, suppose that the service aggregate used by producers has the same form as that used by consumers, as given by (2). Then the price index for services is Q_x, given by (11). The unit cost function for Z_2 is given by $C^2(w,Q_x,r_2)$, where r_2 is the return to the specific factor.

To see how trade or investment in services can affect goods production, first suppose that there is no specific factor K_2, so that labour and services are the only input. Also suppose initially that Z_2 is a non-traded good or service. Then, with perfect competition, the price of Z_2 is completely determined by labour and service costs. In the absence of trade in services, the equilibrium variety of services will be the same as before, but will be augmented by the derived demand for services from Z_2 producers. Now, consider the effects of liberalizing trade or investment in services. This will increase the variety of services available and therefore will lead to a fall in the price index Q_x. The cost and price of Z_2 will therefore fall, generating additional gains from trade. Consumers gain both from wider access to services, but also from cheaper Z_2 production.

Next, suppose that Z_2 is a traded good, and that the specific factor is required. Suppose Home is small, but that it has a larger endowment of the specific factor than Foreign. Then, prior to services trade liberalization, Home's small market will result in a high service price index for the Z_2 industry. Despite the relative abundance of the factor specific to Z_2, Home may be an importer of good 2, and, indeed, it is possible that, if services are sufficiently important in production, then Z_2 may not be produced at all. If the services sector is fully liberalized, so that Home has access to all foreign services, then the service price index will be equalized across countries. Then, because of its abundance of the specific factor K_2, Home will export good 2.

That is, services trade liberalization can generate "vent for surplus" gains from trade. Specific factors or resources in excess supply may not have a ready market, unless producers have access to a wider variety of services. Allowing any of the

modes of supply of service trade can create a market for these factors and generate additional gains from trade.

A4. Example of possible losses from trade-induced elimination of local services

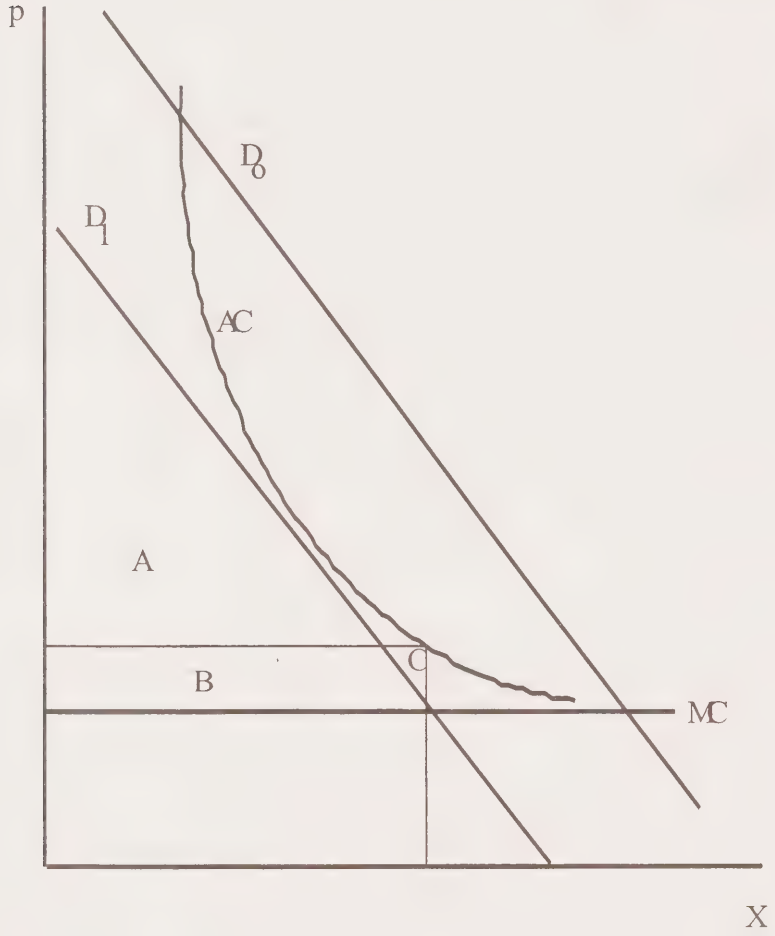
In the main text, it was noted that, once we depart from the assumption of symmetry in product varieties, then it is possible that allowing access to foreign service providers can lead to the collapse of locally produced services, even when it is socially efficient for them to be provided. This differs from the earlier example of regulation in Appendix A2, since, in this case, there is no externality. The result here is driven by the presence of fixed costs. The example is due to Snape (1977) and can be illustrated with the following diagram.

Let X be the local service that is an imperfect substitute for a foreign-provided service. Average cost is AC, which declines because of a fixed cost. Marginal cost is MC. With no foreign access, demand for the local service is D_0, and the local service is viable, since demand is above average cost for a range of outputs.

When foreigners are given domestic market access, some consumers switch to the foreign service, causing the demand for local services to shift inwards to D_1. Since demand is now below average cost, the local service is not viable (assuming firms are unable to charge non-linear prices), and the industry shuts down. Despite the collapse of the local service industry, it would be socially efficient for it to continue to produce, as long as the consumer surplus is greater than the unrecovered fixed costs; that is, if $A > C$, as is the case in the example in the figure above.

Whether or not trade improves overall, welfare depends on the magnitude of direct gains from trade relative to the costs of the loss of the local variety. Once again, this is not an argument against trade liberalization in principle, as long as the government has the policy instruments available to efficiently correct the market failure. However, in practice, government intervention in such cases may be difficult, since a fair amount of information may be required to target the correct local

services for support. Resistance to trade liberalization from those particularly affected by the loss of their local service is likely to ensue, and this resistance can be quite justifiable.



References

Bagwell, Kyle and Robert W. Staiger, "The role of export subsidies when product quality is unknown," *Journal of International Economics*, 1989.

Baldwin, Robert E., "Measurable Dynamic Gains from Trade," *Journal of Political Economy*, 100 (1992): 162-174.

Benjamin, Nancy and Xinshen Diao, "Liberalizing Services Trade in APEC: A General Equilibrium Analysis with Imperfect Competition." *Pacific Economic Review* 5(1). (2000): 49-75

Brainard, S. Lael, "A simple theory of multinational corporations and trade with a trade-off between proximity and concentration," NBER Working Paper No. 4269, February 1993.

Brander, James A. and Barbara J. Spencer, "Tariff protection and imperfect competition," in H. Kierzkowski, ed. *Monopolistic Competition and International Trade* (Oxford University Press, 1984).

Brecher, Richard A. and Ehsan U. Choudri, "Immiserizing Investment from Abroad: The Singer-Prebisch Thesis Reconsidered," *Quarterly Journal of Economics* 97 (1982): 181-190.

Brown, Drusilla K., Alan V. Deardorff, and Robert M. Stern. "Modeling Multilateral Liberalization in Services," *Asia-Pacific Economic Review* 2 (1996): 21-34.

Brown, Drusilla K. and Robert M. Stern,. "Measurement and Modeling of the Economic Effects of Trade and Investment Barriers in Services," Tufts University, Discussion Paper 2000-01.

Burgess, David F., "Services as Intermediate Goods: The Issue of Trade Liberalization," in Ronald W. Jones and Anne O. Krueger, *The Political Economy of International Trade*, Oxford: Basil Blackwell, 1990.

Chadha, Rajesh, Drusilla K. Brown, Alan V. Deardorff and Robert M. Stern, "Computational Analysis of the Impact on India of the Uruguay Round and the Forthcoming WTO Trade negotiations," Discussion Paper No. 459, School of Public Policy, University of Michigan, 2000.

Chen, Zhiqi and Lawrence Schembri, "Measurement of Trade Barriers in Services," in John M. Curtis and Dan Ciuriak (eds), Trade Policy Research 2002 (Ottawa: Department of Foreign Affairs and International Trade, May 2002).

Copeland, Brian R. and M. Scott Taylor, "Free Trade and Global Warming: A Trade Theory View of the Kyoto Protocol," NBER Working Paper No. 7657, April 2000.

Curtis, D.C.A., "Trade Policy to Promote Entry with Scale Economies, Product Variety, and Export Potential," *Canadian Journal of Economics*; 16 (1983): 109-121.

Das, Satya P., "Trade, Skill Acquisition and Distribution," mimeo, Indian Statistical Institute, 2001.

Deardorff, Alan V. "Comparative Advantage and International Trade and Investment in Services," in Robert M. Stern, (ed.), *Trade and Investment in Services: Canada/U.S. Perspectives*, Toronto: Ontario Economic Council, 1985.

Deardorff, Alan V., "International Provision of Trade Services, Trade, and Fragmentation," Discussion Paper No. 463, School of Public Policy, University of Michigan, August 2000.

Dee, Philippa and Hanslow, Kevin. "Multilateral Liberalisation of Services Trade," Productivity Commission of Australia, March 2000.

Dixit, Avinash K., "Trade Policy with Imperfect Information," in R.W. Jones and Anne O. Krueger, (eds.), *The Political Economy of International Trade*, Basil Blackwell (1990).

Dixit, Avinash K. and Victor Norman, *Theory of International Trade* (1980).

Ethier, Wilfred J., "Decreasing Costs in International Trade and Frank Graham's Argument for Protection," *Econometrica* 50 (1982a): 1243-1268.

Ethier, Wilfred J., "National and International Returns to Scale in the Modern Theory of International Trade," *American Economic Review* 72 (1982b): 389-405.

Falvey, Rodney E., "Tariffs, Quotas and Piecemeal Policy Reform," *Journal of International Economics* 25 (1988): 177-183.

Findlay Ronald and Henryk Kierzkowski, "International Trade and Human Capital: A Simple General Equilibrium Model," *Journal of Political Economy* 91 (1983).

Fink, Carsten, Aaditya Mattoo, Ileana Neagu, "Trade in International Maritime Services: How Much Does Policy Matter?" World Bank, February 2001.

Francois, Joseph F., "Trade in Producer Services and Returns Due to Specialization under Monopolistic Competition," *Canadian Journal of Economics* 23 (1990): 109-124.

Francois, Joseph F., "Producer Services, Scale and the Division of Labor," *Oxford Economic Papers*, 42 (1990): 715-729.

Fujita, Masahisa, Paul Krugman and Anthony J. Venables, *The Spatial Economy: Cities, Regions, and International Trade*, Cambridge, MIT Press, 1999.

Grossman, Gene M., "The Gains from International Factor Movements," *Journal of International Economics* 17 (1984): 73-83.

Grossman, Gene M., and Elhanan Helpman, *Innovation and Growth in the Global Economy*, Cambridge, MIT Press, 1991.

Grossman, Gene M. and Henrik Horn, "Infant-Industry Protection Reconsidered: The Case of Informational Barriers to Entry," *Quarterly Journal of Economics* 103 (1988), 767-787.

Helpman, Elhanan, "A Simple Theory of Trade with Multinational Corporations." *Journal of Political Economy* 92 (1984): 451-472.

Helpman, Elhanan. and Paul Krugman, *Market Structure and Foreign Trade*, Cambridge, MIT Press, 1985.

Hill, T. P., "On Goods and Services," *Review of Income and Wealth*, 23 (1977): 315-338.

Hoekman, Bernard and C. A. Primo Braga, "Protection and Trade in Services," Policy Research Working Paper No. 1747, World Bank, 1997.

Jones, Ronald W. and Henryk Kierzkowski, "The Role of Services in Production and International Trade: A Theoretical Framework," in R.W. Jones and Anne O. Krueger, *The political economy of international trade*, Oxford: Basil Blackwell, 1990.

Jones, Ronald W. and Frances Ruane, "Appraising the Options for International Trade in Services," Oxford Economic Papers, 42, (1990): 672-687.

Konya, Istvan, "Optimal Immigration, Assimilation and Trade," mimeo, Northwestern University, 2000.

Krugman, Paul, "Increasing Returns, Monopolistic Competition and International Trade," *Journal of International Economics*, 1979.

Krugman, Paul, "Scale Economies, Product Differentiation, and the Pattern of Trade," *American Economic Review*, 70 (1980), 950-959.

Krugman, Paul and Anthony J. Venables, "Globalization and the Inequality of Nations," *Quarterly Journal of Economics* 110 (1995).

Lipsey, Richard G. and Lancaster, Kelvin J., "The General Theory of Second Best", *Review of Economic Studies*, 24(1), (1956): pp. 11-32.

Markusen, James R., "Factor Movements and Commodity Trade as Complements," *Journal of International Economics* 13 (1983): 341-356.

Markusen, James R., "Multinationals, Multi-plant Economies, and the Gains from Trade," *Journal of International Economics* 16 (1984): 205-226.

Markusen, James R., "Trade in Producer Services and in Other Specialized Intermediate Inputs," *American Economic Review* 79 (1989): 85-95.

Markusen, James R. and Keith E. Maskus, "General-Equilibrium Approaches to the Multinational Firm: A Review of Theory and Evidence," NBER Working Paper No. W8334, June 2001.

Markusen, James R. and James R. Melvin, "Tariffs, Capital Mobility, and Foreign Ownership," *Journal of International Economics* 9 (1979): 395-409.

Markusen, James R. and James R. Melvin, "Trade, Factor Prices and the Gains from Trade with Increasing Returns to Scale," *Canadian Journal of Economics* 14 (1981): 450-469.

Markusen, James R. and Lars E.O. Svensson, "Trade in Goods and Factors with International Differences in Technology," *International Economic Review* 26 (1985): 175-192.

Markusen, James R., Anthony J. Venables, D. Eby Konan, and Kevin H. Zhang, "A Unified Treatment of Horizontal Direct Investment, Vertical Direct Investment, and the Pattern of Trade in Goods and Services," NBER Working Paper No. 5696, August 1996.

Markusen, James R. and Anthony J. Venables, "Multinationals and the New Trade Theory," *Journal of International Economics* 46 (1998): 183-203.

Markusen, James R. and Anthony J. Venables, "The Theory of Endowment, Intra-industry and Multinational Trade," *Journal of International Economics* 52 (2000): 209-234.

Markusen, James R., Thomas F. Rutherford and David Tarr, "Foreign Direct Investments in Services and the Domestic Market for Expertise," NBER Working Paper No. W7700, May 2000.

McKibbin, J. Warwick, Robert Shackleton and Peter J. Wilcoxen, "What to Expect from an International System of Tradable Permits for Carbon Emissions," *Resource and Energy Economics* 21 (1999): 319-346.

Melvin, James R., "Increasing Returns as a Determinant of Trade," *Canadian Journal of Economics* 2 (1969): 389-402.

Melvin, James R., "Trade in Producer Services: A Heckscher-Ohlin Approach," *Journal of Political Economy* 97 (1989): 1180-1196.

Mundell, Robert A., "International Trade and Factor Mobility", *American Economic Review*, 47 (1957): 321-335

Nicolaides, Phedon, *Liberalizing Trade in Services*, Royal Institute of International Affairs, 1989.

OECD, "Quantification of Costs to National Welfare from Barriers to Services Trade: A Literature Review," Paris, September 2000.

Persson, Torsten and Guido Tabellini, "Political Economics and Public Finance," NBER Working Paper No. 7097, April 1999.

Petri, Peter A. "Foreign Direct Investment in a Computable General Equilibrium Framework," mimeo, 1997.

Rodriguez, Francisco and Dani Rodrik, "Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence," NBER Working Paper 7081, April 1999.

Roy, Christine, "An Overview: Understanding the Service Sector and Trade in Services," Trade and Economic Policy Paper No. 98/02, Department of Foreign Affairs and International Trade, Canada, November 1998.

Sampson, Gary and Richard H. Snape, "Identifying Issues in Trade in Services," *World Economy* 8 (1985): 171-182.

Sapir, André and Chantal Winter, "Services Trade," in David Greenaway and L. Alan Winters (eds.), *Surveys in International Trade*, Oxford: Basil Blackwell, 1994.

Sauvé, Pierre and Robert M. Stern, *GATS 2000: New Directions in Services Trade Liberalization*, Brookings Institution, 2000.

Snape, Richard H., "Trade Policy in the Presence of Economies of Scale and Product Variety," *Economic Record*, 53 (1977): 525-534.

Srinivasan, T.N., and Jagdish N. Bhagwati, "Outward-Orientation and Development: Are Revisionists Right?", mimeo, Yale University, 1999.

Taylor, M. Scott, "Once-off and Continuing Gains from Trade," *Review of Economic Studies*, 61 (1994): 589-601.

Trefler, Daniel, "The Long and Short of the Canada-U.S. Free Trade Agreement," Mimeo, University of Toronto, 1999.

Van Marrewijk, Charles, Joachim J. Stibora, Albert de Vaal, and Jean-Marie Viaene, "Producer Services, Comparative Advantage, and International Trade Patterns," *Journal of International Economics* 42 (1997): 195-220.

Vousden, Neil, *The Economics of Trade Protection* Cambridge University Press, 1990.

Woodland, Alan D., *International Trade and Resource Allocation* North Holland, 1982.

Young, Alwyn. "Learning by Doing and the Dynamic Effects of International Trade" *Quarterly Journal of Economics*. May 1991: 369-405.b

Measuring the Barriers to Trade in Services: Literature and Methodologies

Zhiqi Chen and Lawrence Schembri*

Introduction

To facilitate ongoing negotiations to liberalize services trade in the context of the round of multilateral negotiations agreed at Doha, Qatar, in November 2001, it is important to have accurate measures of the various possible barriers to international trade in services. Accordingly, this chapter reviews and evaluates the literature on the measurement of barriers to trade in services in both conceptual terms (how to measure them) and empirical terms (how restrictive existing barriers have been found to be).

In approaching this issue, it is important to keep in mind several important characteristics of trade in services:

First, the General Agreement on Trade in Services (GATS), which provides the framework for the liberalization of international trade in services, classifies trade in services into 155 service types and four modes of supply:

1. Cross-border supply: A service is supplied from a supplier's country of residence to a consumer's country of residence.
2. Consumption abroad: A service is supplied through the movement of a consumer to a supplier's country of residence.
3. Commercial presence: A service is supplied through the movement of a commercial organization to a consumer's country of residence.

* The authors are affiliated with Carleton University. This chapter is based on a report commissioned by the Department of Foreign Affairs and International Trade (DFAIT). The views expressed in this report, however, are entirely those of the authors and do not necessarily reflect those of DFAIT.

4. Presence of natural person: A service is supplied through the movement of a natural person to a consumer's country of residence.

Barriers to trade in services can be put in place in each of the four modes of supply.

Second, except in the case of Mode 1 (an important example of which is cross-border e-commerce), trade in services does not usually involve consumers and service suppliers interacting across borders; rather, transactions typically occur within one country or the other. Given this, impediments to services trade normally take the form of regulations or other measures that effectively limit the access of foreign services suppliers to the domestic market, rather than border measures such as tariffs. As a result, the measurement of barriers to services trade faces the same types of challenges as those involved in measuring non-tariff barriers (NTBs) to merchandise trade.

Third, international mobility of production factors is often needed for services trade to take place. For example, Mode 3 of services trade, establishing commercial presence in a country, usually involves the movement of capital in the form of foreign direct investment (FDI). Restrictions on FDI are common in sectors such as telecommunications, and thus can have significant implications for services trade. Even more problematic is the movement of labour (Mode 4), since this raises the usually sensitive issues of immigration and/or the right of foreign nationals to work. Accordingly, restrictions in these areas are also highly relevant.

In addition, there are two general issues of classification to bear in mind. First, trade-restrictive measures can be categorized as either reducing the access of foreign service providers to the domestic market—the issue of market access; or as discriminating against foreign providers once they have entered the domestic market—the issue of national treatment. Second, barriers can be classified according to whether they impinge on the right of establishment (Mode 3) or the right to carry on trade in services in a foreign country from a home base (Modes 1, 2 and 4).

The remainder of this chapter is organized as follows. First, we discuss various methods that have been used to measure barriers to trade in services and the actual estimates obtained using these methods. We then review the models that have been used to quantify the economic impact of these barriers. Finally, we evaluate the strengths and weaknesses of these methods and models, and conclude by making some recommendations.

Quantifying Barriers to Trade in Services

Research into the measurement of services trade barriers is fairly recent. Generally speaking, measures of barriers to trade in services parallel those that were previously developed to measure NTBs to merchandise trade, and thus can be classified in terms familiar from the NTB literature, namely frequency measures, quantity-based measures and price-based measures.

Frequency Measures

The most widely used frequency measures are those developed by Hoekman (1995) using the GATS commitment schedules of member countries. Hoekman classifies these commitments into three categories, and assigns a numerical score to each category:

1. If no restrictions are applied for a given mode of supply in a given sector, a value of 1 is assigned.
2. If no policies are bound for a given mode of supply in a given sector, a value of 0 is assigned.
3. If restrictions are listed for a given mode of supply in a given sector, a value of 0.5 is assigned.

Hoekman calls these scores the *openness/binding factors*. Since, as noted above, there are 155 non-overlapping service sectors in the GATS classification list, and for each sector there are four possible modes of supply, a total of 620 such openness/binding factors exist for each member country.

Using these factors, Hoekman calculates three *sectoral coverage indicators* (hereafter the "Hoekman indices"). The first is calculated as the number of commitments made by a country in its GATS schedules divided by the 620 maximum

possible.[1] The second, which Hoekman calls "average coverage," is equal to the sectors/modes listed as a share of maximum possible, weighted by the openness/binding factors.[2] The third is also a frequency ratio. It is the share of "no restriction" commitments in either (a) a member's total commitments, or (b) relative to the 155 possible sectors.

While the original purpose of these coverage indicators was to quantify GATS commitments,[3] Hoekman argues that they provide information on the relative restrictiveness of policy regimes pertaining to service industries because the coverage in each country's schedule is an indicator of its policy stance—the higher the coverage, the more open the regime.

There are two ways in which these coverage ratios can be used for this purpose. First, the restrictiveness of a country's policy in a sector can be measured by the ratio equalling (1- the Hoekman indices).[4] For example, if a country has made commitments in 10 percent of the 620 possible sector/modes, then using the first Hoekman index it would get a restrictiveness score of .9, meaning that 90 percent of its sector/modes are closed. Alternatively, "tariff equivalents" can be constructed using a country's coverage ratio, as Hoekman (1995) has done. He does so by first constructing a list of benchmark guesstimates of what tariff equivalents of the most protectionist nation might be. Then the "tariff equivalent" of a given country is obtained by multiplying this guesstimate by (1 minus the

---

[1] This is similar to the frequency ratio developed for measuring NTBs to merchandise trade. The NTB frequency ratio is calculated as the number of product categories subject to NTBs divided by the total number of product categories.

[2] This is similar to the import coverage ratio developed for measuring the value of imports covered by NTBs. The NTB import coverage ratio is calculated as the value of imports in a product category subject to NTBs divided by total imports in the product category.

[3] See Hoekman (1995) p. 338.

[4] Indeed, this is how PECC (1995) measures the impediments to services trade in APEC member economies.

Hoekman indices).[5] Thus, if the most restrictive country worldwide had restrictions equivalent to a 50 percent tariff, then a country with a 0.9 restrictiveness index as in the preceding example, would have a tariff equivalent of 45 percent (i.e. 0.9 times 50).

A more elaborate set of frequency measures, called the *trade restrictiveness indices*, has been constructed by a team of researchers from Australia's Productivity Commission, the University of Adelaide, and the Australian National University for six service industries: telecommunications (Warren 2001a), banking (McGuire and Schuele 2001), maritime transport (McGuire et al 2001), education (Kemp 2001), distribution (Kalirajan 2000) and professional services (Nguyen-Hong 2000). In addition, Hardin and Holmes (1997) have developed frequency indices to measure the size of barriers to FDI across service industries.

To develop these indices, the actual restrictions on trade and investment in a service industry are compiled from a number of sources. These restrictions are then assigned scores and grouped into categories, each of which is assigned a numeric weight. These scores and weights are based on subjective assessments of the costs of restrictions to economic efficiency. Finally, the indices are computed using these scores and weights.

Typically, several indices are calculated for each industry to measure different aspects of barriers to trade. For example, several researchers have calculated two indices, one covering restrictions relevant for foreign service suppliers (the "foreign index") and the other covering restrictions applying to all suppliers (the "domestic index"). The domestic index is an indicator of restrictions on market access, while the difference between the foreign and domestic index is a measure of deviations from national treatment. To gain a better understanding of the Australian approach, we discuss each of their studies below in somewhat more detail.

[5] Hoekman's estimates of tariff equivalents have been used by several studies that estimate the economic impact of service trade barriers. For example, see Brown et al. (1996) and Chadha (2000).

The data source used by Warren (2001a) is from a survey conducted by the International Telecommunication Union (ITU). The survey, entitled *Telecommunication Reform 1998*, contains information on actual government policies toward the telecommunications industry in 136 countries (Warren 2001a, p. 76). Using the information, Warren constructs five separate indices, three of which are designed to capture the restrictions on all potential entrants (market access), while the remaining two are designed to capture the restrictions on potential foreign entrants (national treatment). Within each of these two groups, Warren constructs separate indices for trade and investment.

For each index, Warren devises a weighting/scoring system based on his assessment of the relative importance of the restrictions on the state of competition. For example, for the index titled "MA/Invest (fixed)", which captures policies that discriminate against all potential entrants seeking to supply fixed network services via investment in Malaysia, Warren uses a weighting/scoring system based on answers to the following three questions:

(a) Does competition operate in the market? A score of 1 to 3 is given based on the number of competitors in the market. The score 3 is given for a market with three or more competitors.
(b) Does policy allow for competition in the market? A score of 1 is provided if full competition is allowed, with 0.5 for partial competition and 0 for a monopoly situation.
(c) Is the incumbent privatized? A score of 0 to 1 is given based on the fraction of the incumbent that is privatized.

Based on his assessment of their relative importance, Warren attaches weights 3, 2 and 1 respectively to the above three questions. The index is thus a weighted average of these scores. A higher index value indicates a more liberal regime.

McGuire and Schuele (2001) construct trade restrictiveness indices for banking services. They compile a list of non-prudential restrictions on banking services from a number of sources including the GATS schedules for financial services, WTO Trade Policy Reviews, and APEC Individual Action

Plans.[6] These restrictions are given scores and then grouped into 10 categories, each of which is assigned a weight. Their weighting/scoring system is reproduced in Tables 1a and 1b in the tabular section at the end of this chapter. As can be seen from these tables, restrictions considered to impose a greater cost on economic efficiency are given a greater weight. For example, restrictions covering the licensing of banks are assigned a larger weight than restrictions on joint-venture arrangements. These weights and scores are then used to calculate two indices: a foreign index that covers restrictions relevant for foreign banks and a domestic index that covers restrictions applying to all banks.

McGuire et al. (2001) construct trade restrictiveness indices for the maritime transport services. Their primary source of information is a questionnaire distributed by the WTO's Negotiating Group on Maritime Transport Services (NGMTS 1994). In addition, supplementary information has been taken from a number of sources, including the GATS schedules and WTO Trade Policy Reviews.[7] The restrictions are also given scores and grouped into 14 categories, which are assigned weights. Tables 2a and 2b present the weighting/scoring system used to construct the indices for maritime services. As in the McGuire and Schuele (2001) study on the banking sector, separate indices are calculated for domestic and foreign maritime service suppliers.

The trade restrictiveness index developed by Kemp (2001) for education services uses a method similar to that of Hoekman (1995). The index is based on GATS commitment schedules and adopts a three-value scoring system: a full commitment to liberalize trade is assigned a score of 0, a partial commitment is assigned a value of 0.5, and an unbound commitment receives a value of 1. Kemp's approach is similar to Hoekman's but differs in that he divides education into five subsectors (primary, secondary, higher, adult and other) and assigns a weight to each

[6] For a complete list of sources, see McGuire and Schuele (2001), p. 203.

[7] For a complete list, see McGuire et al. (2001), p. 173.

based on the relative importance of the subsector in trade. Specifically, higher education is the most traded sector and receives a larger weight of 0.4, while each of the remaining four subsectors is allocated a weight of 0.15. The index is then calculated by taking the weighted average of scores associated with the five subsectors in the four modes of supply and two categories of limitations (market access and national treatment). Kemp also conducts a sensitivity analysis by computing a second index using an alternative scoring system in which unbound sectors are treated as being unrestricted and given a score of 0 rather than 1. The reason for computing this second index is the belief that it is not always the case that unbound sectors are totally restricted.

Kalirajan (2000) develops trade restrictiveness indices for distribution services, including wholesale, retail and sales by commission agents and franchisers. The method used by Kalirajan is the same as McGuire and Schuele (2001) and McGuire et al (2001). Information on restrictions to trade in distribution services for 38 economies is drawn from a number of sources, including GATS schedules, WTO Trade Policy Reviews, OECD publications and the Tradeport database. These restrictions are classified into 12 categories, and weights/scores are assigned based on judgment of their economic impact. The weighting/scoring system used is reproduced in Tables 3a and 3b. Both domestic and foreign indices are calculated.

Nguyen-Hong (2000) develops trade restrictiveness indices for four types of professional services: legal, accountancy, architectural and engineering services. The method here is the same as that used by McGuire and Schuele (2001), McGuire et al. (2001) and Kalirajan (2000). Information on actual restrictions on professional services are compiled from the OECD Inventory of Measures Affecting Trade in Professional Services, the WTO Questionnaire on Restrictions in the Accountancy Services Sector, the APEC Directory on Professional Services, ILSAC's Legal Services Country Profiles, and a few other sources. These restrictions are classified into 17 categories. The weights assigned to these

categories are shown in Table 4. Like most of the Australian studies, both domestic and foreign indices are calculated.

While most of the frequency measures reviewed above cover the barriers to FDI either directly or indirectly (through the inclusion of commercial presence), Hardin and Holmes (1997) is the only comprehensive study that focuses on measuring the size of barriers to FDI across sectors. The methodology is similar to those used by the rest of the Australian team. First, information on actual restrictions is compiled, drawing mainly on APEC members' Individual Action Plans and the *APEC Guide to Investment Regimes of Member Economies*. These restrictions are classified into five categories (see Table 5). Second, scores are assigned to these restrictions based on subjective assessments of their relative economic costs, ranging from 1 for a complete ban on FDI to 0 for a completely open regime. Details of the scores used are reproduced in Table 5. Third, for each individual GATS subsector, these scores are added to obtain an index; these are then further aggregated into indices for 11 broad sectors. Each sector index is obtained by taking the simple average of the subsector indices. Hardin and Holmes also conduct sensitivity analysis by recalculating the indices using two alternative scoring systems.[8]

From the above discussion, we can see that there are three important differences between the initial Hoekman (1995) approach, also used by the Pacific Economic Cooperation Council (PECC) (1995), and the later approach used by the Australian team. First, Hoekman and PECC use the GATS commitment schedules, while the later approach, with the exception of Kemp (2001), attempts to use actual estimates of the size of impediments to trade obtained from a number of sources. Second, Hoekman and PECC use a simple weighting/scoring system with only three values (0, 0.5 and 1), while the Australian team uses more elaborate weighting/scoring systems that attempt to reflect the relative economic impact of different

[8] See Appendix A of Hardin and Holmes (2001) for details.

impediments. The Australian approach, therefore, covers a broader spectrum of trade restrictions and involves a more carefully specified methodology than Hoekman and PECC. The simplicity of the Hoekman approach makes it relatively easy to calculate frequency indices for all 155 GATS sectors using one unified weighting/scoring system. The Australian approach requires more resources and, as a result, so far indices have been computed for only six industries, which are equivalent to approximately 30 percent of the 155 sectors covered by Hoekman (1995).

Finally, variations of the Hoekman approach and the Australian approach have been used by other researchers to construct frequency measures. Several of these studies are worth noting.

Marko (1998) computes two sets of indices to evaluate the WTO Agreement on Basic Telecommunications Services. The first set, computed for 69 member countries of the agreement, is based on the Hoekman approach discussed above. In addition, Marko calculates a second set for a selected group of 15 member countries using a more elaborate weighting/scoring system for different types of restrictions. He groups the list of restrictions on telecommunications services into eight categories based on four modes of supply and two categories of limitations (market access and national treatment). Details of the weights and scores applied to different restrictions are presented in Table 6.

Claessens and Glaessner (1998) calculate "degree of openness" indices for financial services in eight Asian economies. These take into consideration the barriers in the following six categories: the right of establishment and ownership, limits on establishing branch offices and ATMs, restrictions on lending/business activities, limits on universal banking, residency requirement, and restrictions on cross-border trade. In each of these categories, an economy is assigned a score between 1 and 5, with 1 being most closed and 5 most open. An example of how the scores are determined is given in Table 7. A unique feature of the Claessens and Glaessner approach is that they compute indices for both actual

restrictions and GATS commitments. They compiled the list of actual restrictions from a number of sources and, to the extent possible, cross-checked these with country officials and other sources (Claessens and Glaessner 1998, p. 24).

Mattoo (1998) also develops a frequency measure to gauge the commitments made by member countries of the GATS Agreement on Financial Services. His approach is similar to that of Hoekman (1995) but has two important differences. First, Mattoo attaches different weights to different modes of supply. In particular, commercial presence is given a dominant weight, ranging from 0.75 to 0.85, because available statistics indicate that it is currently the most important mode of supplying financial services (Mattoo 1998, p. 40). Second, while using Hoekman's three-value scoring system for commitments on cross-border supply and consumption abroad, Mattoo devises a more elaborate scoring system for commitments on commercial presence. Details of the weighting/scoring system used by Mattoo are reproduced in Table 8. The liberalization index, as Mattoo calls it, is then the weighted average of these scores given to a country's commitments.

Colecchia (2001) proposes a methodology for calculating frequency measures for professional services. It is very similar to the methodology used by the Australian team. A notable difference is that Colecchia's restrictiveness index is not a simple weighted average of scores. Rather, it is the *deviation* of the weighted average from some benchmark. The benchmark, in turn, is defined to be a level of protection/openness considered to be the norm: "that is, the level that is normally applied by all countries given certain regulatory objectives (e.g. consumer protection, confidentiality and accountability)" (Colecchia 2001, p. 251). By focusing on the deviation from the norm, Colecchia argues, this benchmark approach makes the indices of different sectors more comparable and permits sectoral aggregation into an overall index of trade restrictiveness (Colecchia 2001, p. 247).

Quantity-based Measures

Quantity-based measures of trade restrictiveness are typically derived using econometric models based on the standard models of trade determination: the Heckscher-Ohlin model where trade is motivated by comparative advantage; the Helpman-Krugman model where trade is motivated by product differentiation, and the gravity model, where an important part of trade is determined by the relative size and proximity of trading partners (in terms of both distance but also other factors such as language, culture, etc.). The sizes of NTBs are measured either by the residuals from the estimated regression (i.e. the difference between the level of actual trade and the level predicted by the model), or by using various dummy variables (Deardorff and Stern 1998, p. 24).

Most such studies have been confined to the merchandise trade field. However, two studies have developed quantity-based measures of barriers to services trade: Hoekman and Francois (1999) and Warren (2001b). Francois and Hoekman fit a gravity model to bilateral trade in services between the United States and its major trading partners. The independent variables are per-capita income, gross domestic product, and a Western hemisphere dummy variable. The differences between actual and predicted imports (the residuals) are taken to be indicative of the size of barriers to trade. These are then normalized relative to the free trade benchmarks (which are assumed to be Hong Kong and Singapore). These quantity measures have also been converted into tariff equivalents by assuming a demand elasticity of -4.

Warren (2001b) develops a quantity-based measure for telecommunication services. He uses an econometric model to estimate the impact of impediments to trade and investment on the quantity of telecommunications services consumed. The study is done for both fixed and mobile services. The independent variables in this model are measures of per-capita income, quality of networks, waiting lists, household density, population density, and (of particular concern here) impediments to trade and investment. For the measures of

impediments to trade and investment, Warren uses the frequency indices developed in Warren (2001a). The results from the regression model are then used to estimate the quantity impact of the barriers to trade and investment in the industry for 136 economies. These quantity estimates are also converted into tariff equivalents using a price elasticity of demand.

Note that there are two major differences between Warren's approach and the quantity-based approach used by Francois and Hoekman (1999). First, the quantity impact in Warren is measured in terms of quantity consumed rather than quantity traded. Ideally, these quantity measures should be based on quantity traded. However, for a variety of reasons, this has proved difficult for many types of services, primarily because of the lack of bilateral trade data (Warren 2001b, p. 85). Second, Warren does not use residuals or dummy variables to measure the size of impediments. Instead, he uses the trade restrictiveness index, which allows him to isolate the impact of these impediments from that of other factors (e.g. per-capita income and population density).

Price-based Measures

Price-based measures derive estimates of barriers to trade from differences in domestic and foreign prices ("price wedges"). If there are sufficient data on prices, then, following Deardorff and Stern (1998), such measures can be constructed directly by comparing the domestic price of the imported good (P) with a reference foreign price (P*).[9] In this approach, the percentage difference between the domestic and foreign price is comparable to a tariff (T), provided the price differences are not

[9] Depending on data availability, different types of prices are used for P and P* in the calculation of T. In the merchandise trade literature, these include actual prices (the preferred approach), c.i.f. invoice prices, the domestic price in a particular foreign exporting country, or the minimum domestic price among all foreign exporters adjusted for transport costs. Deardorff and Stern (1998, pp. 21-23) also discuss other price measures (e.g. quota transfer price) that can be used in the calculation of T.

due to factors such as sunk costs and entry deterrence strategies by incumbent firms, rather than government-imposed barriers (see Ross (1999) for a detailed discussion on various types of barriers to entry). Price wedges can also be quantified using econometric methods or derived from quantity-based measures with the help of elasticities of demand and supply.

To date, empirical price-comparison studies have been limited to NTBs in merchandise trade because of the lack of data on relevant prices in services trade. Francois and Hoekman (1999), however, propose a measure based on gross operating margin, defined as total sales revenue minus total average costs divided by total average costs.[10] The gross operating margins are calculated using the financial data reported by firms listed on stock exchanges. These margins provide an indication of the relative profitability of different industries, and hence, the relative magnitude (restrictiveness) of the barriers to entry that may exist. Hoekman (2000, p. 37) suggests two methods to gauge the sizes of trade barriers through the use of these margins. The first one is to use the difference between the average margins of a benchmark country with relatively free trade and the margins of the other countries in the sample. The second method employs the difference between manufacturing and service margins, with the margins in manufacturing serving as the benchmark.

Most price-based measures for services have been obtained by the Australian team using econometric methods. These studies are Trewin (2001) for telecommunications, Kalirajan et al. (2001) for banking, Kang (2001) for maritime transport, Kalirajan (2000) for food distribution, and Nguyen-Hong (2000) for engineering services. All five studies use the following procedure: one, a proxy of the domestic price is identified for the industry in question; two, a model is constructed to identify a list of variables that affect the price, one of which is the barriers to trade measured by the trade

[10] We include this measure in the category of price-based measures because operating margins are closely related to prices (or price-cost margins, to be more precise).

restrictiveness indices developed by the Australian team; three, a regression model is specified and estimated; and four, the estimated coefficients and trade restrictiveness index are used to calculate the sizes of price wedges for individual economies. This last step is done only in three of the five studies, but it could have been done without difficulty in all studies.

To measure trade impediments, Trewin (2001) uses the indices developed by Marko (1998) and Warren (2001a). While his stated aim is to "identify and decompose the observed wedge between telecommunications prices" (p. 100), in fact he estimates cost, not price wedges. Since higher costs normally translate into higher prices, however, the wedges estimated by Trewin capture at least part of the price impact of the impediments.[11]

Price wedges caused by restrictions on banking services have been estimated by Kalirajan et al. (2001). While banks engage in a wide variety of financial services ranging from lending to securities, this study is focused on their core business of intermediation between depositors and lenders. The price of such intermediation services is measured by a bank's interest margin, the difference between the interest rate the bank charges on loans that it makes and the rate that it pays its depositors. The objective of Kalirajan et al. is to estimate the impact of non-prudential restrictions on the interest margins of banks. To achieve this objective, they extend a model developed by Saunders and Schumacher (1997) to include measures of non-prudential restrictions. Specifically, Kalirajan et al. argue that a bank's interest margin is influenced by the following factors: prudential regulations such as capital and liquidity

[11] Trewin employs the frontier cost model as the theoretical basis for his empirical relations. The independent variables are the log of total costs of providing various telecommunications services. In addition to measures of impediments to trade and investment, the independent variables include measures of output, real wages, interest rates, capacity, quality and technological change. The coefficients of these independent variables in the frontier cost functions are estimated using the maximum likelihood method. However, Trewin stops short of using the estimated coefficients to calculate the size of cost impact for each country.

requirements, net non-interest expenses, market structure, interest rate volatility, and non-prudential restrictions. Because this model involves both bank-specific and economy-wide variables, a two-stage procedure is used for estimation. In the first stage, interest margins are regressed on prudential regulations and net non-interest expenses. From the estimation, they isolate the "pure interest spreads," that is, the interest margins that are common to all banks in an economy. In the second stage, the pure interest spreads are regressed on the remaining independent variables, namely market structure, interest rate volatility and non-prudential restrictions. The measure of non-prudential restrictions used in this study is the domestic and foreign restrictiveness indices developed by McGuire and Schuele (2001). Kalirajan et al. then use the estimated coefficients to construct the price wedges for individual countries.

Kang (2001) estimates the price impact of barriers to trade in maritime transport services by postulating that the price of shipping is a function of barriers to trade in maritime services, distance between trading partners, scale of bilateral trade, and stages of economic development of trading partners. The price of maritime services is measured by the shipping margin (shipping expenses). As measures of barriers to trade, Kang uses the indices developed by McGuire et al. (2001). Like Trewin (2001), Kang estimates his regression models but does not use his estimation results to calculate the size of price wedges for individual countries.

Kalirajan (2000) estimates the impact of the barriers to trade in food distribution services for 18 economies. The price wedge in this study is measured by price-cost margins. Based on the ideas contained in Betancourt and Gautschi (1993) and Mueller (1986), Kalirajan postulates that the price-cost margin of a food distribution firm is a function of firm-specific variables, such as the accessibility of its location, the assortment of goods available, the ability to deliver goods in the desired form and at the desired time, the level of information provided, and the ambience of the establishment (e.g., fixtures and fittings), as well as economy-wide variables such as industry concentration

and barriers to entry. As in Kalirajan et al. (2001) for banking services, Kalirajan (2000) adopts a two-stage estimation procedure. In the first stage, the effects of firm-specific factors are estimated and then removed. The net effects common to all firms in an economy are then regressed on the trade restrictiveness index (developed in the first half of his study) and a dummy variable that measures restrictive practices by private sectors (e.g. exclusive contracts). The estimation results are then used to compute the impact on individual economies.

While Nguyen-Hong (2000) computes trade restrictiveness indices for four types of professional services, he estimates a price wedge only for engineering services. Like Kalirajan (2000), the price wedge is measured by price-cost margin. The econometric model is based on the Mueller (1986) framework in which a firm's profitability is assumed to be a function of its market share, market concentration, the extent of product differentiation and other factors. Nguyen-Hong extends this framework to include the effects of trade restrictions as measured by the trade restrictiveness indices developed in the first half of his study. The price impacts of the trade barriers are calculated for 20 economies using the estimated coefficients.

Empirical Estimates of Barriers to Trade in Services

Frequency Measures

The estimates of Hoekman's (1995) frequency measures are summarized in Table 9. This table shows that, overall, high-income countries made significantly more GATS commitments (47 percent of the GATS list) than did low- and middle-income countries (16 percent). Hoekman (1995) also reports results for individual countries; those for Canada are reproduced in column 4 of Table 9. Examining these data, it can be seen that, in terms of both the unweighted frequency ratio ("unweighted average count") and the weighted coverage ratio ("average coverage"), Canada made significantly more commitments than did the average high-income country. For example, the unweighted

average count is 56.8 percent for Canada and 47.3 percent for the average of high-income countries.

PECC (1995) measures impediments to services trade by calculating the values of (1 minus the Hoekman indices). Two frequency measures are used. The first one is calculated using the Hoekman index derived as the number of sector/modes with no restrictions divided by the number of possible listings; the second one is calculated using Hoekman's average coverage ratio. The averages of these indices for 16 APEC countries are illustrated in Figure 1. This figure shows that, measured by the first frequency ratio, about 78 percent of all possible service markets are impeded in the APEC region. Even when partial commitments are taken into account, about 63 percent of service markets in this region are closed to international transactions. The index values for various services in Canada are presented in Figure 2. According to this index, environmental services, value added telecommunications, rental services and computer services are the most open in Canada, while sectors such postal services, basic telecommunications, audiovisual services and education are the most restricted.

The Australian team has calculated trade restrictiveness indices for six industries: telecommunications, banking, maritime transport, education, distribution, and professional services. Figures 3 to 6 illustrate some of the index values obtained by these studies. As one might expect, for each industry there is a high degree of variation in the index values for different countries. Among a selected group of economies in the Americas, Canada has the most open market to foreign trade and investment in banking and maritime transport services, but is the most restricted market in accountancy services (see the foreign indices in Figures 3 to 5). In terms of openness to trade in telecommunications services, Canada is in the middle of the top 20 trading countries (see Figure 6).

Marko (1998) also calculates frequency indices for telecommunications. Recall that Marko's indices are based on commitments made in the WTO Agreement on Basic Telecommunications Services, while the indices developed by the Australian team (Warren 2001a) are based on an ITU survey

of actual restrictions. Figure 7 illustrates a comparison of these two types of indices. It indicates that there is some degree of correlation between the two types of indices. Indeed, Warren calculates that the Pearson correlation coefficient between the two is 0.64 (Warren 2001a, p. 83). On the other hand, from Figure 7 we can also see that there are a few significant mismatches between the two measures (e.g. estimates for Korea, Hong Kong, and Japan are quite different under the two methodologies).

The comparison done by Claessens and Glaessner (1998) for financial services shows the same pattern. As Table 10 illustrates, there appears to be a fairly close correlation between GATS measures and actual practices. At the same time, commitments can fall short of current practices as well as go beyond them. Hong Kong, for example, is committed to more liberal entry in insurance services than current practices. Many Asian economies, however, have made commitments that fall short of current practices, particularly in banking services, but also in other financial services. The Philippines, for example, has committed to allowing ownership in banking only up to 49 percent, while under current practice limits go up to 60 percent for existing banks and 100 percent for new banks (Claessens and Glaessner 1998, p. 25).

Mattoo (1998) reports his indices for GATS commitments on financial services for 73 countries. In Table 11, we reproduce his results for eight developed countries in his study. Keeping in mind that a higher index value means a commitment to more liberal trade, we note that Canada's commitment levels in all four areas of banking and insurance are below the averages of the developed countries.

In Colecchia (2001), indices for trade barriers in accountancy services are calculated for four countries: the United Kingdom, France, Australia and the United States. The restrictiveness index values for these four countries are 0.5, 0.7, 1.15, and 1.55.[12] These numbers suggest that among the four

[12] These index values are deviations from the "benchmark," which is normalized to a value of 0.

countries the United Kingdom is the most open, while the United States is the most restrictive to the provision of accountancy services.

Hardin and Holmes (1997) have calculated a restrictiveness index for foreign direct investment (FDI) in 15 APEC economies. The values of this index are presented in Table 12. These data indicate that communications and financial services tend to be subject to the most stringent FDI controls. The least-restricted sectors are business, distribution, environmental and recreational services. Across the economies, Korea, Indonesia, Thailand, China and the Philippines score relatively high, while the United States and Hong Kong tend to have the lowest index values. For Canada, the index value is 0.2 for seven out of a total of 11 sectors, reflecting horizontal restrictions across sectors. If we compare Canada and Australia, two high-income, small, open economies, we see that Canada has higher index values than Australia in all but one sector (financial services).

Price- and Quantity-based Measures[13]

Warren (2001b) reports his estimates of quantity impacts resulting from restrictions on investment in telecommunications services. The results for the world's 20 largest service-trading countries are reproduced in Table 13. Numbers in column 2 are quantity impacts of market access restrictions on fixed telecommunications services, while those in column 3 are quantity impacts of national treatment restrictions on the same services. The numbers in column 4 are quantity measures of market access restrictions on mobile services. As can be seen from Table 13, there are large variations in the quantity impacts across countries, ranging from 0 percent for United States and United Kingdom to 267 percent for China (arising from the restrictions related to national treatment in fixed services). Even within the developed countries, the quantity impacts can

[13] Trewin (2001) and Kang (2001) do not calculate the sizes of price impacts for individual countries. Hence, these studies are not discussed in this section.

go as high as 7.5 percent (due to market access restrictions to mobile services in Spain). The quantity impacts for Canada are more moderate, ranging from 0.3 percent to 3.5 percent.[14]

The price impacts of restrictions on banking services estimated by Kalirajan et al. (2001) are reproduced in Table 14. The numbers in column 2 measure the price impacts of restrictions on foreign banks. They range from 5 percent to 60 percent. The numbers in column 3 indicate the price impacts of restrictions that apply equally to domestic and foreign banks, and they range from 0 percent to 23 percent. Canada is among the countries with the smallest price impacts.

Kalirajan's (2000) study of food-distribution services reaches the surprising conclusion that a country's price-cost margin in this sector decreases with the height of barriers to trade. He interprets this result as an indication that barriers to trade in this sector raise the costs (as opposed to the prices) of distribution services. Hence, he estimates "cost impact indicators." The estimated cost impacts of restrictions on establishment by foreign firms are reproduced in Table 15.[15] They suggest that, for Canada, these restrictions have raised the costs of distribution by 3.09 percent, the sixth highest among the 18 economies studied.

Nguyen-Hong's (2000) estimates of price wedges caused by restrictions on foreign engineering service firms are reported in Table 16. They range from 1 percent to 15 percent, but they are below 10 percent for the majority of the 20 economies studied. The price wedge for Canada is a modest 5.3 percent, right in the middle of this group of economies.

Francois and Hoekman's (1999) estimates of tariff equivalents for business/financial services and construction are

[14] Warren (2001b) also estimates tariff equivalents associated with these quantity impact numbers. However, he cautions that, because the price elasticity of demand used to calculate the tariff equivalents is unsatisfactory, the focus should be on the quantity impact measures (Warren 2001b, p. 100).

[15] Kalirajan (2000) focuses on the restrictions on establishment because the estimated coefficient for this variable is significant at 5 percent, while the estimated coefficient for restrictions on ongoing operations is not.

reproduced in Table 17. One interesting observation from Table 17 is that barriers to services trade are not always higher than those to merchandise trade. For instance, in the case of South and Southeast Asia, the Middle East and North Africa, the estimated tariff equivalents for business/financial services are lower than the average merchandise tariffs.

The average gross operating margins calculated by Francois and Hoekman (1999) are reproduced in Table 18. The numbers in columns 2 and 3 suggest that while there are some specific service sectors whose margins are generally lower than those in manufacturing (e.g. retail and wholesale), margins in service sectors as a whole are significantly higher than those in manufacturing sectors. In Canada, for example, the average gross margin in all service sectors is 46 percent higher than that in manufacturing. Across countries, if the United States is taken as a competitive benchmark country, it can be observed that in many developing countries, margins are significantly higher. Hoekman (2000, p. 37) takes this as evidence that policies may be in place in developing countries that restrict competition and allow incumbent firms to garner rents.

Quantifying the Economic Impact of Barriers

In recent years, much effort has been directed at modelling the economic impact of barriers to services trade. Compared with the results of studies that aim only to the measure of size of barriers, the issue addressed in the preceding section, these studies can provide more profound insights as to the impact of barriers to services trade, including, for example, on the mechanisms through which the barriers raise prices and reduce quantity, the general equilibrium linkages among different sectors resulting from the trade barriers, and the welfare implications for consumers and for the economy as a whole.

The economic impact of barriers to trade in services is typically estimated by simulating calibrated theoretical models of international trade. The first step is to construct, on the basis of economic theory, a general or partial equilibrium model to capture the interaction among consumers, producers and

governments. In the case of a general equilibrium model, the linkages among different sectors of an economy are also represented. The parameter values used in these models are usually chosen from existing estimates. In particular, the parameter values representing the size of barriers to trade are based on the estimates obtained using the methods reviewed in the preceding section. For example, Hoekman's (1995) estimates of tariff equivalents have been used in several studies. After the model is calibrated, it is used to simulate the effects of trade liberalization (e.g. a 20 percent reduction in all barriers to trade). The impact of the barriers to trade can be computed by comparing the actual situation with the simulated free trade equilibrium.

The only published partial equilibrium analysis that quantifies the impact of services trade liberalization is by Johnson et al. (2001); this study estimates the effects of increasing competition in international air services. In their theoretical model, consumers view services provided by different airlines as imperfect substitutes, and they care about the price and various non-price attributes of travel (e.g. the frequency of services). Airlines are modelled as oligopolists that choose prices and flight frequencies to maximize their profits. Johnson et al. use this model to simulate the effects of entry by a new airline, as well as the effects of liberalization of air services by establishing an open club among Australia, China, Hong Kong and Japan.

In particular, this study quantifies the effects on economic welfare, measured by the sum of consumer surplus and airline profits, associated with these changes. To do this, it considers three different scenarios based on the degrees of freedom granted to the airlines of member countries in the club. Under the first, the airlines of member countries are freed from restrictions on their operations and allowed to achieve the benchmark productivity of the most efficient carrier. In the second scenario, airlines of club members become free to fly wherever they like within the club, and to enter new markets previously denied them under the bilateral system. Under the third scenario, the two effects are considered together. In other

words, airlines of member countries improve productivity, and are allowed to enter new markets and establish new networks. The simulation results for these three scenarios are reported in Table 19. From column 2, we see that the net effects of an open club on member countries are an increase in consumer surplus, a reduction in profit, and overall a gain in total surplus ranging from A$42.8 million to A$253.2 million. However, in the non-member countries, the gain in consumer surplus is outweighed by the loss in profit, resulting in a reduction in total surplus ranging from A$0.4 million to A$6.3 million.

With the above exception, studies in this area use computable general equilibrium (CGE) models. The two most commonly used types of CGE models are various versions of Global Trade Analysis Project (GTAP) model and the Michigan Model of World Production and Trade. Studies of the impact of services trade barriers based on the GTAP model are: Hertel et al. (1999); the Australian Department of Foreign Affairs and Trade (1999); Dee and Hanslow (2000a); and Verikios and Zhang (2000). Applications of the Michigan model are Brown et al. (1996); Chadha (2000); Chadha et al (2000); and Brown and Stern (2000). Since a detailed survey of these has already been done by the OECD (2000) and Brown and Stern (2000), here we present only a brief summary of those studies that model Canada as a separate economy.

(a) Brown et al. (1996) simulate the impact of a 25 percent multilateral reduction in Hoekman's (1995) tariff equivalents of service barriers. They consider four scenarios based on different assumptions on market structure and product differentiation. The estimated welfare gains for Canada range from US$2,330 million to US$3,979 million, or from 0.4 percent to 0.7 percent of GDP.

(b) Chadha et al. (2000) study the impact of a reduction in Hoekman's (1995) tariff equivalents of service barriers by 33 percent. The estimated welfare gain for Canada is US$20,226 million or 2.8 percent of GDP.

(c) In Benjamin and Diao (2000), liberalization of services trade is modelled as the removal of market segmentation and a reduction in fixed costs by 10 percent. The economic

welfare of a country is measured by a welfare index. According to this study, liberalization of services trade will increase Canada's welfare by between 1.36 percent and 3.13 percent.

(d) Dee and Hanslow (2000a) study the impact of removal of barriers to trade in services. Their results suggest that Canada would *lose* from services trade liberalization by US$499 million.

(e) Verikios and Zhang (2000) simulate the impact of the elimination of barriers to trade in communications and financial services. Canada is estimated to gain US$39 million from trade liberalization in communications services, but to lose US$44 million from trade liberalization in financial services.

(f) Brown and Stern (2000) simulate the impact of removal of service barriers under three different scenarios for international capital markets. Their simulation results show that Canada's gain from removal of all barriers to services trade would be between US$73.3 billion and US$85 billion, or between 12.9 percent and 14.9 percent of GNP.

From the above summary, we can see that estimates of economic impact on Canada vary widely. At one extreme, Dee and Hanslow (2000a) show that Canada is expected to lose by US$499 million; in fact Canada is the only country expected to lose rather than gain from trade liberalization in both goods and services. At the other extreme, Brown and Stern (2000) show that Canada is expected to gain as much as US$85 billion; making Canada the largest gainer from services trade liberalization among all economies in their model.

Evaluation and Recommendations

The objective of this section is to evaluate the methodologies reviewed above and to recommend a framework to be used for the analysis of barriers to trade in services in Canada and in Canada's trading partners. The first thing we should note when evaluating these frameworks is that, because of the limitations imposed by our state of knowledge about how economies

operate and by the severe lack of data, there is no perfect method to measure the barriers to trade in services. Each method has its strengths and weaknesses. As a result, trade-offs have to be made in deciding which method to use.

We should also recognize that the research in this area began only recently with Hoekman's (1995) pioneering work. As a result, the studies reviewed in this report should be viewed as preliminary attempts at measuring barriers to services trade. Both the methodology of measurement and the actual estimates of barriers can and will be improved as more research is done in this area.

When evaluating different methods of measuring barriers to trade in services, we consider the following factors:

(a) Information content. What type and amount of information is conveyed by a measure? Other things being equal, the more informative a measure is, the more desirable it is.

(b) Data and other resource requirements. As has been recognized by every researcher in this field, the lack of data is a serious constraint on our ability to measure barriers to services trade. A more elaborate model can usually produce more informative results, but at the same time it requires more data and other resources (e.g. human and computing resources).

(c) Accuracy and reliability. Is the information provided by a measure accurate and reliable? A related issue is the ease with which economists and non-economists (e.g. trade negotiators) can ascertain the accuracy and reliability of the estimates. A measure would have limited practical use in trade negotiations if it were produced using a complicated methodology that could not be easily understood by anyone other than a very small number of experts.

(d) Scope. Can the measures be applied to a wide range of service sectors and countries? The key here is the comparability of estimates for different service sectors and countries. A high degree of comparability across sectors, for example, will allow the measure to be applied to a large number of sectors.

(e) Intended use. In the end, this is the most important factor in determining the most appropriate framework to use. Broadly speaking, measures of barriers to trade can be used for two related purposes: assessment of the impact of trade liberalization and guidance for trade negotiations. In the latter regard, the following questions are relevant from a Canadian perspective:

i) What are the major barriers to Canada's services exports?

ii) What domestic policies create barriers to the importation of services and are detrimental to economic growth and welfare in Canada?

The latter information would be particularly helpful if it allowed Canadian negotiators to participate more effectively in the negotiations over the liberalization of trade in services.

Evaluation

When evaluating different frameworks, we use a top-down approach, starting with a comparative analysis of size measures versus impact measures. We then contrast the frequency measures with price-/quantity-based measures. Finally, we compare the two different approaches to constructing frequency indices.

Size Measures versus Impact Measures

It is clear that impact measures contain much richer information content than size measures. The former can reveal the magnitudes of impact on consumer welfare, firms' profits, as well as resource allocation, while the latter merely indicate the sizes of the barriers. The scope of impact measures is generally wider than that of size measures because the general equilibrium models that are used to derive them allow the consideration of many sectors and many economies simultaneously. The richer information content and wider scope, however, come at a significant cost in terms of the much

larger amount of data and more resources that these models demand. Indeed, only a small number of researchers can produce such estimates because of the large initial costs of constructing general equilibrium trade models.

More importantly, impact measures are weaker than size measures in terms of their accuracy and reliability. There are several reasons for this.

First, because impact measures require substantially more data, the inadequacy of the existing data on barriers to services trade is more serious for impact measures than size measures. Often, researchers are forced to use less than satisfactory proxies for variables on which direct observations are not available.[16]

Second, the general equilibrium models used to obtain impact measures are calibrated using only one historic set of observations, leaving the estimated results potentially sensitive to the use of different sets of observations, especially if the structure of the economy has changed over time. Sophisticated general equilibrium models require an extensive assumed theoretical framework. Hence, the accuracy and reliability of the generated estimates are conditional on the validity of the theoretical framework. The econometric models used to derive size measures, on the other hand, rely less on theoretical structure and more on data, thus making the estimated results statistically more reliable.

Third, the complexity of general equilibrium models makes it difficult to gauge the accuracy and reliability of the estimates obtained. To people who are not familiar with the technical intricacies of CGE modelling (which would include most economists and practitioners), these models are a black box and

---

[16] For example, in their general equilibrium model, Dee and Hanslow (2000a) have to extrapolate the sizes of trade barriers for all service sectors from the size estimates of only two industries: banking and telecommunications services. However, there is no reason to believe that in all countries, the barriers to trade in these two industries are typical of all service industries. In fact, Hardin and Holmes (1997) find that these two sectors tend to be subject to the most stringent FDI controls (see Table 12).

it is difficult for them to judge objectively the reliability of the estimates. For example, as discussed above, the estimated impact of services trade liberalization for Canada ranges from a loss of US$499 million (Dee and Hanslow 2000a) to a gain of US$85 billion (Brown and Stern 2000), a range of over 10 percent of GDP! This variation in the estimates could be due to a variety of reasons, such as differences in the structures and assumptions of the models, differences in parameter values used, or differences in data sources. In practice, it is very difficult to reconcile widely different estimates. As a result, it is impossible to assess with a high degree of confidence the accuracy and reliability of these estimates.

Admittedly, various approaches to size measurement can also produce a wide range of estimates. The accuracy and reliability of size estimates, however, are normally easier to gauge and the differences less difficult to reconcile. For price- or quantity-based measures obtained using econometric models, well-developed statistical theory provides widely used test statistics that determine the goodness of fit with a high degree of accuracy (e.g. R^2 and t-statistics). A major advantage of frequency measures, meanwhile, is the transparency of the construction: it is relatively easy to understand how the index values are calculated. If two approaches yield different index values, it is relatively easy to pinpoint what has caused the difference (e.g. a difference in weighting/scoring system). This allows informed debates over the appropriateness of various aspects of the approaches (e.g. whether the score assigned to a particular type of trade barrier is too low or too high). Finally, since most CGE models use size measures such as Hoekman's (1995) tariff equivalents as inputs, the accuracy and reliability of impact measures so obtained cannot be any better than that of the size measures themselves.

The rich information content of impact measures makes them useful for the purpose of assessing the impact of trade liberalization. Estimates of the benefits from free trade in services can help mobilize political support for trade liberalization. On the other hand, to provide guidance to trade negotiations, a measure has to be reasonably accurate and

reliable, and be easy to calculate and understand. As discussed above, in this regard, impact measures are weaker than size measures. Indeed, we agree with the OECD (2000, p. 13) assessment that the estimates from CGE models are "unlikely ever to be sufficiently accurate to be used directly in the actual conduct of GATS negotiations." Therefore, we believe that efforts should be focused on the development of size measures, since this is the approach that will likely have the greatest practical benefits.

Frequency versus Price-/Quantity-based Measures

As discussed above, price-/quantity-based measures provide richer information content than frequency measures, but have generally greater data and resource requirements and raise issues of comparability across sectors,[17] thus leading to a narrower scope of application. An important exception is Francois and Hoekman's (1999) approach based on operating margins; this price-based measure has relatively wide scope because it can be applied uniformly to a broad range of sectors and countries.

In the important area of accuracy and reliability, frequency measures are better than price-/quantity-based measures. To see this point, let us further divide the price-/quantity-based measures into two categories: those obtained with a direct approach and those derived indirectly.

With the direct approach, the measures are estimated directly using a proxy for trade barriers (namely frequency indices). The price/quantity estimates obtained by the Australian team are an example of this method.

With the indirect approach, the measures are inferred indirectly from the estimation residuals or the deviation of gross operating margins from some free trade benchmark, as in Francois and Hoekman (1999).

---

[17] This is particularly true of the price-/quantity-based measures developed by the Australian team, which have narrower scope because they are determined on an industry-by-industry basis.

Because the direct approach employs frequency measures as explanatory variables in the empirical model, the accuracy and reliability of the resulting estimates cannot be any better than that of these frequency measures themselves.

The indirect approach, such as deriving estimates based on gross operating margins, is subject to even more serious deficiencies in accuracy and reliability. First, when size measures are inferred indirectly from residuals, they are very sensitive to the accuracy of the specification of the empirical model. A poor fit may lead one to conclude erroneously the existence of large barriers. Second, even when the model is correctly specified, it is still problematic to attribute all deviations from a competitive equilibrium to government-erected barriers. In principle, there are many barriers to entry that can cause price to deviate from its competitive level. Not all of these barriers are erected by governments.[18] While using a country or an industry as a free-trade benchmark, and focusing on the deviation from the benchmark may remove part of the influence of these non-government related barriers, some unknown portion of the influence may still remain.

The indirect approach has, therefore, an inherent bias toward exaggerating the size of government-erected barriers to trade. Of course, frequency measures can also over- or under-estimate the actual size of barriers when, for example, the weighting/scoring system is not specified properly. However, such a bias is not systematic; moreover, by carefully scrutinizing the weighting/scoring system used and all other

[18] For example, consider a situation where technology know-how gained from years of learning-by-doing gives an incumbent firm an absolute cost advantage. Suppose that in one country, one lucky firm started early and was able to use the cost advantage to obtain a monopoly position. Meanwhile, in a second country, several firms started at about the same time and ended up sharing the market equally. If we were to use the indirect approach of Francois and Hoekman (1999) in this situation, we would be led to take the second country as the benchmark and inappropriately attribute cost differences between the two countries to government-erected barriers in the first country.

aspects of the calculation process, one can at least get a sense of whether there is, in fact, a bias.

Considering the above factors from the perspective of providing guidance to trade negotiations, we believe that frequency measures contain enough information on the size of barriers to be used as a basis for negotiating the targets and monitoring the progress of trade liberalization. Furthermore, they are superior in terms of accuracy and reliability. For these reasons, frequency measures are preferable to price-/quantity-based measures for the purpose providing guidance to trade negotiations.

Different Types of Frequency Indices

Broadly speaking, there are two different approaches to calculating frequency indices: the Hoekman (1995) and the Australian approach. The differences between the two approaches have already been discussed. Here we re-examine these differences in terms of their information content, data and resource requirements, accuracy and reliability, and scope.

(a) Information content. We rank the Australian approach higher in information content because most of the indices developed using this approach are based on information drawn from a variety of sources over and above the GATS commitment schedules.

(b) Data and other resource requirements. The use of wider sources of information and more elaborate weighting/scoring systems means that the Australian approach requires more resources to implement.

(c) Accuracy and reliability. In this area, each of the two approaches has its strengths and weaknesses. Because the Australian approach uses actual restrictions to trade and investment (rather than simply a positive list of GATS commitments) and weighting/scoring systems that are based on judgment about the economic impact of different restrictions, the indices so derived tend to be more accurate reflections of the actual sizes of barriers than the Hoekman approach. On the other hand, the Australian approach

requires more subjective judgment in the construction of indices. A more elaborate weighting/scoring system obviously requires more subjective judgment. What is not as obvious is that the selection of various types of government policies to be included in the list of barriers for the calculation of indices also involves subjective judgment. On the other hand, Hoekman's three-value weighting/scoring system leaves little room for subjective judgment. Hoekman's list of barriers is drawn from an international agreement, and again, there is no room for subjective selection. The Hoekman approach, therefore, is more objective.

(d) Scope. The Hoekman approach has a wider scope than the Australian approach because it uses the same information source and the same weighting/scoring system for all sectors. As a result, the Hoekman approach has a higher degree of comparability across sectors than does the Australian approach.

Taking all of the above factors into consideration, we believe that the Australian approach to frequency index is preferable to the Hoekman approach on an industry-by-industry basis. The Hoekman approach, however, would be preferable if measures are needed for a broad set of industries and countries for which comparable detailed data are not available. At the same time, we should be aware of the subjective elements inherent in the Australian approach and guard against strategic manipulations of weighting/scoring systems and the barrier list.

Having said that, we also recognize that on these issues there will be honest differences of opinions among different researchers and practitioners arising from their different perspectives. In all likelihood, there will be debates over how a restrictiveness index for a particular sector should be constructed. Therefore, it is important that Canada joins the efforts in the development of restrictiveness indices so that Canada's views are represented in these debates.

Conclusions and Recommendations

In the past five years, significant progress has been made in the measurement of both the size and economic impacts of barriers to services trade. Frequency measures, price-based measures, and quantity-based measures have been constructed to gauge the sizes of the barriers in many service sectors, while CGE models have been used to estimate the economic impacts of the barriers. At the same time, it should also be recognized that the measurement of barriers to services trade is a very new area and that more research is needed to refine both the methodology and the actual estimates.

Each of the approaches reviewed in this chapter has its strengths and weaknesses; which of these approaches is the best one to use depends to a large extent on the objectives of the user. In terms of Canada's interest and priorities in negotiations on liberalization of services trade, we believe that, on balance, the Australian approach and the Hoekman approach to frequency indices are the most promising.

Based on the above analysis, we make the following recommendations:

(a) Measurement of barriers to trade in services should focus on size rather than impact measures.

(b) Among various frameworks for size measures, the Australian approach to constructing frequency indices is the most preferable on an industry basis for a well-defined set of industries. The Hoekman approach may be preferable for a broader set of industries and countries.

(c) For those industries for which frequency measures have already been developed by the Australian team (namely, telecommunications, banking, maritime transport, education, distribution, and professional services), consideration should be given as to whether improvements can be made by, for example, including additional sources of information and/or using a different weighting/scoring system.

(d) For those industries for which frequency measures have not been developed by the Australian team, consideration should be given to Canada taking a lead in undertaking studies to construct indices for these sectors.[19]

(e) As a first step, efforts should be focused on developing or improving indices for service sectors that are of particular significance to Canada.

[19] The information challenges are quite significant, however. To construct frequency measures, we need a comprehensive list of barriers to services trade on a sectoral basis, one for each country. Collecting such information is difficult. In theory, such a list can be compiled by conducting a comprehensive review of all government policies and practices that might restrict trade in services. Such a comprehensive review, however, would be very costly. Although this can be done for selected sectors in a few selected countries, it would not be feasible to do this for every sector in every country. A more feasible approach would be to draw from a variety of existing information sources, such as industry associations, government departments and international organizations. The GATS commitment schedules are a very useful starting point for the construction of such a list. However, the information in the GATS schedules is limited because it is a positive list and it is a list of commitments rather than actual restrictions. Additional lists of actual barriers have been compiled by various international organizations. They include the WTO Trade Policy Reviews, the World Bank's Trade in Services Database, the EU Market Access Sectoral and Trade Barriers Database, the National Trade Estimate Reports on Foreign Trade Barriers by the Office of the United States Trade Representatives (USTR), and the APEC Individual Action Plan.

Tables

Table 1a. Weights and Scores: Restriction on Commercial Presence in Banking Services

Weight	Score	Restriction Category
0.20		Licensing of banks
	1.00	Issues no new banking licences
	0.75	Issues up to three new banking licences with only prudential requirements
	0.50	Issues up to six new banking licences with only prudential requirements
	0.25	Issues up to 10 new banking licences with only prudential requirements
	0.00	Issues new banking licences with only prudential requirements
0.20		*Direct investment*
		The score is inversely proportional to the maximum equity participation permitted in an existing domestic bank. For example, equity participation to a maximum of 75 percent of a bank would receive a score of 0.25
0.10		*Joint-venture arrangement*
	1.00	Issues no new banking licences and no entry is allowed through a joint venture with a domestic bank
	0.50	Bank entry is only through a joint venture with a domestic bank
	0.00	No requirement for a bank to enter through a joint venture with a domestic bank
0.02		*Permanent movement of people*
	1.00	No entry of executives, senior managers and/or specialists
	0.80	Executives, specialists and/or senior managers can stay up to one year
	0.60	Executives, specialists and/or senior managers can stay up to two years
	0.40	Executives, specialists and/or senior managers can stay up to three years
	0.20	Executives, specialists and/or senior managers can stay up to four years
	0.00	Executives, specialists and/or senior managers can stay for a period of five years or more

Source: McGuire and Schuele (2001) pp. 204-205, Table 12.1.

Table 1b. Weights and Scores: Other Restrictions in Banking Services

Weight	Score	Restriction Category
0.15		*Raising funds by banks*
	1.00	Banks are not permitted to raise funds in domestic market
	0.75	Banks are not permitted to raise funds in domestic capital market
	0.50	Banks are restricted in accepting deposits from the public
	0.00	Banks can raise funds from any source with only prudential requirements
0.15		*Lending funds by banks*
	1.00	Banks are not permitted to lend to domestic clients
	0.75	Banks are restricted to a specified lending size or lending to government projects
	0.50	Banks are restricted in providing certain services such as credit cards, leasing and consumer finance
	0.25	Banks are directed to lend to housing and small business
	0.00	Banks can lend to any source with only prudential restrictions
0.10		*Other business of banks: insurance & securities services*
	1.00	Banks can only provide banking services
	0.50	Banks can provide banking services plus one other line of business: insurance or securities services
	0.00	No restrictions on conducting other lines of business
0.05		*Expanding the number of banking outlets*
	1.00	One outlet with no new outlets permitted
	0.75	Number of outlets is limited in number and location
	0.25	Expansion of outlets subject to non-prudential regulatory approval
	0.00	No restrictions on banks expanding operations
0.02		*Composition of the board of directors*
		The score is inversely proportionately to the percentage of the board that can comprise foreigners. For example, a score of 0.80 is allocated where 20 percent of the board of directors of a bank can comprise foreigners.
0.01		*Temporary movement of executives, senior managers and/or specialists*
	1.00	No temporary entry
	0.75	Temporary entry for up to 30 days
	0.50	Temporary entry for up to 60 days
	0.25	Temporary entry for up to 90 days
	0.00	Temporary entry for over 90 days

Source: McGuire and Schuele (2001) pp. 204-205, Table 12.1.

Table 2a. Weights and Scores: Restrictions on Commercial Presence in Maritime Transport Services

Weight	Score	Restriction Category
0.15		*Conditions on the right to fly the national flag*
	0.40	Commercial presence is required in the domestic economy
	0.30	50 percent or more of equity participation must be domestic
	0.20	50 percent or more of the crew are required to be domestic
	0.10	Ship must be registered
0.10		*Form of commercial presence*
	1.00	Measures which restrict or require a specific type of legal entity or joint venture arrangement
	0.50	Shipping service suppliers must be represented by an agent
	0.00	No restrictions on establishment
0.10		*Direct investment in shipping service suppliers*
		The score is inversely proportional to the maximum equity participation permitted in an existing shipping service supplier. For example, equity participation to a maximum of 75 percent of an existing shipping service supplier would receive a score of 0.25
0.10		*Direct investment in onshore maritime service suppliers*
		The score is inversely proportional to the maximum equity participation permitted in an existing onshore maritime service supplier. For example, equity participation to a maximum of 75 percent of an existing onshore service supplier would receive a score of 0.25
0.02		*Permanent movement of executives, senior managers and/or specialists*
	1.00	No entry
	0.80	Stay up to one year
	0.60	Stay up to two years
	0.40	Stay up to three years
	0.20	Stay up to four years
	0.00	Stay for five years or more

Source: McGuire et al (2001) pp. 176-178, Table 10.2.

Table 2b. Weights and Scores: Other Restrictions in Maritime Transport Services

Weight	Score	Restriction Category
0.10		*Cabotage*
	1.00	Foreigners generally cannot provide domestic maritime services
	0.75	Foreigners that fly the national flag can provide domestic maritime services
	0.50	Restrictions on type and length of time cargoes can be carried
	0.00	No cabotage restrictions
0.10		*Transportation of non-commercial cargoes*
	1.00	Private shipping service suppliers cannot carry non-commercial cargoes
	0.50	National flag shipping service suppliers can carry non-commercial cargoes
	0.00	No restrictions on access to non-commercial cargoes
0.10		*Port services*
	0.30	Some restrictions on access to ports
	0.20	Mandatory use of pilotage
	0.15	Mandatory use of towing
	0.10	Mandatory use of tug assistance
	0.05	Mandatory use of navigation aids
	0.05	Mandatory use of berthing services
	0.05	Mandatory use of waste disposal
	0.05	Mandatory use of anchorage
	0.05	Mandatory use of casting off
0.05		*Discretionary restrictions, including for retaliation*
	1.00	Governments are able to impose selective restrictions
	0.00	Governments are unable to impose selective restrictions
0.05		*United Nations Liner Code*
	1.00	Economy is party to the Code and applies Article 2
	0.75	Economy is party to the Code but doesn't apply Article 2
	0.00	Economy is not party to the Code
0.05		*Government permits conferences*
	1.00	Government permits the operation of conferences
	0.00	Conferences are subject to effective competition
0.05		*Bilateral maritime services agreements on cargo sharing*
		The score for an economy is taken from the 35 by 35 matrix of bilateral agreements on cargo sharing

Table 2b (Continued)

Weight	Score	Restriction Category
0.02		*Composition of the board of directors* The score is inversely proportionately to the percentage of the board that can comprise foreigners. For example, a score of 0.80 is allocated where 20 percent of the board of directors of a maritime service supplier can comprise foreigners
0.01		*Temporary movement of executives, senior managers and/or specialists*
	1.00	No temporary entry
	0.75	Temporary entry up to 30 days
	0.50	Temporary entry up to 60 days
	0.25	Temporary entry up to 90 days
	0.00	Temporary entry over 90 days

Source: McGuire et al (2001) pp. 176-178, Table 10.2.

Table 3a. Weights and Scores for Restrictions on Establishment in Distribution Services

Weight	Score	Restriction Category
0.20		*Restrictions on commercial land*
	1.00	Acquisition of commercial land is not permitted
	0.50	Acquisition of commercial land is permitted, but is restricted to a certain size
	0.00	No restrictions on the acquisition of land
0.20		*Direct investment in distribution firms*
		This score will be inversely proportional to the maximum foreign equity participation permitted in a domestic distribution firm. For example, equity participation to a maximum of 75 percent of an existing distribution firm receives a score of 0.25
0.05		*Restrictions on large-scale stores*
	1.00	National legislation prohibits large-scale stores
	0.50	Regional and local authorities restrict large-scale stores
	0.00	No restrictions on large-scale stores
0.075		*Factors affecting investment*
	0.30	Takeovers are hindered by regulation
	0.30	Investors must meet performance requirements
	0.20	Establishment subject to an economic needs test
	0.20	Government screening of investment
0.075		*Local government requirements*
	0.40	Establishment subject to a local environmental impact assessment or zoning requirements
	0.40	Local employment requirements
	0.20	Restrictions on operating hours
0.05		*Permanent movement of executives, senior managers or staff*
	1.00	No entry
	0.80	Allowed to stay a period of up to one year
	0.60	Allowed to stay a period of up to two years
	0.40	Allowed to stay a period of up to three years
	0.20	Allowed to stay a period of up to four years
	0.00	Allowed to stay for a period of more than four years

Source: Kalirajan (2000) Table 2.2.

Table 3b. Weights and Scores for Restrictions on Ongoing Operations in Distribution Services

Weight	Score	Restriction Category
0.075		*Wholesale import licensing*
	1.00	No new import licences are available for wholesalers
	0.50	A limited number of new import licences are available for wholesalers
	0.00	There are no limits on the issue of import licences
0.05		*Limits on the promotion of retail products*
	1.00	Distribution firms are prohibited from using advertising and promotion to market retail products
	0.50	Distribution firms are limited in their use of advertising and promotion to market retail products
	0.00	No restrictions on advertising/promotion of retail products
0.10		*Statutory government monopolies*
		The score for an economy is taken from a table of 16 product categories, in which distribution occurs through statutory government monopolies
0.05		*Protection of intellectual property rights*
	1.00	An economy is on the USTR priority 301 watch list
	0.50	An economy is on the USTR priority watch list
	0.00	Intellectual property rights are not on USTR watch list
0.05		*Licensing requirements on management*
	1.00	All directors or managers or at least a majority of them must be nationals or residents
	0.75	At least one director/manager must be a national or resident
	0.50	Directors and managers must be locally licensed
	0.25	Directors and mangers must be domiciled in the foreign economy
0.025		*Temporary movement of executives, senior managers or staff*
	1.00	No temporary entry
	0.75	Temporary entry up to 30 days
	0.50	Temporary entry up to 60 days
	0.25	Temporary entry up to 90 days
	0.00	Temporary entry over 90 days

Source: Kalirajan (2000) Table 2.2.

Table 4. Restriction Categories for Professional Services

Restriction categories	Relevant to foreign index	Weight	Relevant to domestic index	Weight
Barriers to establishment				
Form of establishment	Yes	0.08	Yes	0.08
Foreign partnership or joint venture	Yes	0.08	No	n.a.
Investment and ownership by foreign professionals	Yes	0.05	No	n.a.
Investment and ownership by non-professional investors	Yes	0.05	Yes	0.05
Nationality requirements	Yes	0.135	No	n.a.
Residency and local presence requirements	Yes	0.135	No	n.a.
Quotas/economic needs test	Yes	0.10	No	n.a.
Licensing and accreditation of foreign professionals	Yes	0.10	No	n.a.
Licensing and accreditation of local professionals	No	n.a.	Yes	0.05
Permanent movement of people	Yes	0.02	No	n.a.
Barriers to ongoing operations				
Activities reserved by law to the profession	Yes	0.05	Yes	0.05
Multidisciplinary practices	Yes	0.05	Yes	0.05
Advertising, marketing, and solicitation	Yes	0.05	Yes	0.05
Fee setting	Yes	0.05	Yes	0.05
Licensing requirements on management	Yes	0.02	No	n.a.
Other restrictions	Yes	0.02	No	n.a.
Temporary movement of people	Yes	0.01	No	n.a.
Total weight		1.00		0.38

Source: Nguyen-Hong (2000) Table 2.2.

Table 5. Weighting/Scoring System Used by Hardin and Holmes (1997)

Type of restriction	Weight
Foreign equity limits on all firms	
no foreign equity permitted	1
less than 50 percent foreign equity permitted	0.5
more than 50 percent and less than 100 percent foreign equity permitted	0.25
Foreign equity limits on existing firms, none on greenfield	
no foreign equity permitted	0.5
less than 50 percent foreign equity permitted	0.25
more than 50 percent and less than 100 percent foreign equity permitted	0.125
Screening and approval	
investor required to demonstrate net economic benefits	0.1
approval unless contrary to national interest	0.075
notification (pre or post)	0.05
Control and management restrictions	
all firms	0.2
existing firms, none for greenfield	0.1
Input and operational restrictions	
all firms	0.2
existing firms, none for greenfield	0.1

Source: Hardin and Holmes (1997) Table A1.

Table 6. Weighting/Scoring System Used by Marko (1998)

Weight	Extent of Restriction
Limitations on Market Access - Cross Border Supply	
1.00	None
0.75	Services unrestricted as at later date
0.50	Subj. to commercial arrangements w. licensed operator(s)
0.25	Only through network of existing operator(s)
0.00	Unbound
Limitations on Market Access - Consumption Abroad	
1.00	None
0.50	Callback not allowed
0.25	Only through network of existing operator(s)
0.00	Unbound
Limitations on Market Access - Commercial Presence	
1.00	None
0.75	Foreign equity allowed greater than 50 percent
0.50	Foreign equity allowed less than 50 percent
0.25	Services exclusively provided
0.00	Unbound
Limitations on Market Access - Presence of National Person	
1.00	None
0.50	Unbound except as indicated in horizontal section
0.00	Unbound
Limitations on National Treatment - Cross Border Supply	
1.00	None
0.50	Unbound except as indicated in horizontal section
0.00	Unbound
Limitations on National Treatment - Consumption Abroad	
1.00	None
0.50	Unbound except as indicated in horizontal section
0.00	Unbound
Limitations on National Treatment - Commercial Presence	
1.00	None
0.75	Restrictions on nationality of directors
0.50	All executives and managers must be citizens
0.25	Conditional up passage of Acts
0.00	Unbound
Limitations on National Treatment - Presence of Natural Person	
1.00	None
0.50	Unbound except as indicated in horizontal section
0.00	Unbound

Source: Marko (1998) Table 3.3.

Table 7. An Example of the Scoring System Used by Claessens and Glaessner (1998)

Restrictions on establishment and ownership	Scores
No limits on establishment or equity acquisition/participation in domestic banks/companies; current practice of grating new licences	5
Foreign branch establishment(s) permitted to establish within specific limits; allowed foreign equity participation in domestic banks/companies: 51 percent and up but less than 100 percent	4
No new licences granted in practice; entry limited to joint ventures only; allowed foreign equity participation in domestic banks/companies of 35 percent to 50 percent	3
Allowed foreign equity participation in domestic banks/companies of 15 percent to 34 percent; economic needs test for foreign broker licences	2
Non-prudential government approval required for establishment (minimum limits on amount of DFI, "certain criteria eligibility"); allowed foreign equity participation in domestic banks/companies: 0 percent to 14 percent	1

Source: Compiled from Claessens and Glaessner (1998) Appendix.

Table 8. Weights/Scoring System Used by Mattoo (1998)

Modal Weights in Insurance and Banking				
	Insurance		*Banking*	
	Life	*Non-life*	*Deposits*	*Lending*
Cross-border supply	0.12	0.20	0.12	0.20
Consumption abroad	0.03	0.05	0.03	0.05
Commercial presence	0.85	0.75	0.85	0.75
Scores for Commitments on Cross-Border Supply & Consumption Abroad				
"Unbound"				0
"None"				1
"Some restrictions"				0.5
Scores for Commitments on Commercial Presence				
No new entry or unbound for new entry				0.10
Discretionary licensing for new entry				0.25
Ceiling on foreign equity at less than 50 percent				0.50
Ceiling on foreign equity at more than 50 percent				0.75
Restrictions on the legal form of commercial presence				0.75
Other minor restrictions				0.75
"Unbound"				0
"None"				1

Source: Compiled from Mattoo (1998) Annex 1.

Table 9. Hoekman's (1995) Frequency Measures

	HIC	LMIC	Canada
Market Access			
Unweighted average "count" (sectors-modes listed as a share of maximum possible)	47.3	16.2	56.8
Average coverage (weighted by openness/binding factors)	35.9	10.3	43.3
Coverage/"count" (average coverage as a share of the average count)	75.9	63.6	76.3
"No restrictions" as a share of average count	57.3	45.5	52.8
National Treatment			
Unweighted average "count" (sectors-modes listed as a share of maximum possible)	47.3	16.2	56.8
Average coverage (weighted by openness/binding factors)	37.2	11.2	46.0
Coverage "count" (average coverage as a share of the average count)	78.6	69.1	81.1
"No restrictions" as a share of average count	65.1	58.0	62.5

Source: Compiled from Tables 4 and 6 in Hoekman (1995). HICs are the high-income countries; LMICs are the low- and middle-income countries

Table 10. Degree of Openness Indices for Financial Services: Commitment (C) versus Practice (P)

	Banking		Securities		Insurance		Capital Control
	C	*P*	*C*	*P*	*C*	*P*	*P*
Hong Kong	4.20	4.75	4.00	4.40	4.40	4.00	4.80
Indonesia	3.15	3.20	3.50	3.00	3.10	2.60	3.60
South Korea	1.10	1.70	1.70	2.10	1.20	2.60	2.65
Malaysia	2.40	2.40	2.50	2.50	2.10	2.10	2.80
Philippines	2.80	3.35	2.40	2.40	2.90	2.80	2.45
Singapore	2.25	2.50	2.70	2.70	4.10	4.10	4.40
Thailand	2.95	2.85	2.00	2.00	2.80	2.80	4.20
India	2.70	2.25	2.50	2.10	1.00	1.00	1.50
Average	2.69	2.88	2.66	2.65	2.70	2.75	3.30

Source: Claessens and Glaessner (1998) Table 10.

Table 11. Liberalization Indices for Banking and Direct Insurance by Mattoo (1998)

	Banking		Direct Insurance	
	Deposits	Lending	Life	Non-life
Australia	0.67	0.80	0.85	0.69
Canada	0.67	0.61	0.64	0.69
European Union	0.67	0.61	0.64	0.69
Iceland	0.88	0.80	0.64	0.59
Japan	0.88	0.80	0.85	0.88
New Zealand	0.88	0.80	0.85	0.69
Norway	0.88	0.80	0.64	0.69
Switzerland	0.88	0.80	0.64	0.69
United States	0.67	0.61	0.64	0.69
Developed Country Average	0.79	0.74	0.71	0.697

Source: Annex Table 3 in Mattoo (1998).

Table 12. FDI Restrictiveness Indices by Hardin and Holmes (1997)

	Australia	Canada	China	Hong Kong	Indonesia
Business	0.183	0.225	0.36	0.015	0.56
Communications	0.443	0.514	0.819	0.35	0.644
Construction	0.175	0.2	0.4	0	0.525
Distribution	0.175	0.2	0.275	0.05	0.525
Education	0.175	0.2	0.525	0	0.525
Environmental	0.175	0.2	0.275	0	0.525
Financial	0.45	0.375	0.45	0.233	0.55
Health	0.175	0.2	0.275	0	0.525
Tourism	0.175	0.2	0.283	0	0.525
Recreational	0.175	0.2	0.275	0	0.525
Transport	0.204	0.235	0.455	0.093	0.525

	Japan	Korea	Malaysia	Mexico	New Zealand
Business	0.06	0.565	0.316	0.289	0.086
Communications	0.35	0.685	0.416	0.739	0.434
Construction	0.05	0.75	0.775	0.45	0.075
Distribution	0.05	0.625	0.075	0.325	0.075
Education	0.2	0.55	0.075	0.45	0.075
Environmental	0.117	0.7	0.075	0.075	0.075
Financial	0.358	0.875	0.608	0.554	0.2
Health	0.05	0.55	0.317	0.408	0.075
Tourism	0.05	0.617	0.542	0.275	0.075
Recreational	0.05	0.55	0.175	0.075	0.075
Transport	0.114	0.573	0.122	0.283	0.131

	Papua New Guinea	Philip-pines	Singapore	Thailand	United States
Business	0.3	0.479	0.261	0.775	0.005
Communications	0.475	0.758	0.518	0.838	0.345
Construction	0.3	0.475	0.25	0.775	0
Distribution	0.3	0.475	0.25	0.775	0
Education	0.3	0.475	0.25	0.775	0
Environmental	0.3	0.475	0.25	0.775	0
Financial	0.3	0.954	0.378	0.875	0.2
Health	0.3	0.475	0.25	0.775	0
Tourism	0.3	0.808	0.317	0.775	0
Recreational	0.3	0.475	0.25	0.775	0
Transport	0.3	0.975	0.25	0.78	0.025

Source: Table A2 in Hardin and Holmes (1997).

Table 13. Quantity Impacts of Restrictions on Investment in Telecommunications

	Fixed Services MA Restrictions	Fixed Services NT Restrictions	Mobile Services MA Restrictions
United States	0.0	0.0	0.0
United Kingdom	0.0	0.0	0.0
France	0.9	5.1	1.8
Germany	0.9	0.0	1.6
Italy	3.4	0.0	4.4
Japan	0.7	0.0	1.1
Netherlands	0.6	0.0	1.1
Spain	6.1	0.0	7.5
Belgium	0.6	3.0	1.2
Luxembourg	0.8	0.0	2.2
Hong Kong	-	-	-
Austria	3.5	0.0	2.2
Canada	0.3	3.5	2.8
Switzerland	3.3	0.0	5.1
Korea	5.5	7.0	9.4
China	110.0	267.0	115.0
Turkey	29.0	18.9	63.0
Singapore	4.8	2.8	2.9
Sweden	2.4	0.0	2.2
Australia	0.8	0.0	1.8

Source: Compiled from Warren (2001b) Table 6.7 (The data for Hong Kong are missing in the original table).

Table 14. The Effects of Non-Prudential Restrictions on Net Interest Margins

	Restrictions on foreign banks	Restrictions on all banks
Argentina	5.34	0.00
Australia	9.30	0.00
Canada	5.34	0.00
Chile	34.00	23.67
Colombia	18.35	3.73
European Union	5.32	0.00
Hong Kong	6.91	2.97
Indonesia	49.32	5.26
Japan	15.26	9.99
Malaysia	60.61	21.86
Philippines	47.63	10.79
Singapore	31.45	8.39
South Korea	36.72	14.93
Switzerland	5.95	0.00
Thailand	33.06	0.00

Source: Kalirajan et al (2001), Table 13.4.

Table 15. The Cost Impact of Foreign Barriers to Establishment in Food Distribution

	Cost Impact (Percent)
Australia	0.57
Belgium	4.87
Canada	3.09
Chile	1.32
France	5.16
Greece	0.25
Hong Kong	0.06
Indonesia	3.66
Ireland	2.70
Japan	2.26
Malaysia	8.23
Netherlands	2.73
New Zealand	0.77
Singapore	0.03
South Africa	0.47
Switzerland	5.24
United Kingdom	2.76
United States	2.26

Source: Kalirajan (2000) Table 4.1.

Table 16. Price Impacts of Restrictions on Foreign Engineering Service Suppliers (Percent)

Economy	Foreign barriers to establishment	Foreign barriers to ongoing operations	All foreign barriers
Austria	11.1	3.5	14.5
Mexico	13.9	0.2	14.2
Malaysia	11.3	0.7	12.0
Indonesia	9.9	0.3	10.2
Germany	4.7	5.5	10.2
Spain	5.1	3.7	8.7
U.S.	5.1	2.2	7.4
Sweden	5.9	0.9	6.8
Japan	3.1	3.4	6.6
Canada	3.1	2.2	5.3
Singapore	4.9	0.2	5.0
Hong Kong	3.6	1.5	5.1
South Africa	3.5	0.2	3.7
Netherlands	3.5	0.2	3.7
Australia	2.1	0.7	2.8
U.K.	2.3	0.2	2.5
Finland	1.8	0.5	2.3
Denmark	0.3	0.8	1.1
France	0.3	0.6	0.9
Belgium	0.3	0.2	0.5

Source: Nguyen-Hong (2000) Table 4.3.

Table 17. Francois and Hoekman's (1999) Estimated Tariff Equivalents Based on a Gravity Model (Percent)

	Average Tariff on Merchandise	Business/ Financial	Construction
North America	6.0	8.2	9.8
Western Europe	6.0	8.5	18.3
Australia and NZ	5.0	6.9	24.4
Japan	6.0	19.7	29.7
China	18.0	18.8	40.9
Taiwan	n.a.	2.6	5.3
Other NICs	n.a.	2.1	10.3
Indonesia	13.0	6.8	9.6
Other Southeast Asia	10.0	5.0	17.7
India	30.0	13.1	61.6
Other South Asia	25.0	20.4	46.3
Brazil	15.0	35.7	57.2
Other Latin America	12.0	4.7	26.0
Turkey	13.0	20.4	46.3
Middle East & North Africa	20.0	4.0	9.5
CEECs + Russia	10.0	18.4	51.9
South Africa	6.0	15.7	42.1
Other Sub-Saharan Africa	n.a.	0.3	11.1
Rest of World	n.a.	20.4	46.3

Source: Hoekman (2000) Table 3.

Table 18. Average Gross Operating Margins of Firms, 1994 – 1996 (Percent)

	Mfg.	All Services	Rec.	Business Services	Const.	Consult.
Australia	15.5	16.6	18.0	13.8	15.3	7.0
Canada	22.6	32.9	60.0	51.7	14.4	19.2
Chile	40.8	44.0			68.7	
China	28.1	49.5			45.9	67.1
EU	23.8	31.6	43.0	32.1	19.3	22.1
Hong Kong	12.8	18.1		6.5	12.9	11.5
Indonesia	34.3	41.3		81.1	22.9	25.3
Japan	26.4	28.7	28.0	31.6	14.2	28.6
Korea	25.7	25.8		41.2	15.3	
Malaysia	6.0	21.6	13.0		18.3	14.7
Mexico	39.3	37.2	20.0		25.7	37.3
NZ	16.6	26.8			13.8	
Philippines	28.6	42.3	20.0		40.2	
Singapore	11.1	22.0	47.0	8.6	10.6	7.7
Taiwan	25.1	41.3	80.0	36.3	21.6	11.1
Thailand	27.3	52.6	85.0	35.8	38.1	-8.8
U.S.	21.1	42.3	47.0	56.2	20.2	
Other Cairns	31.1	39.0			28.9	26.2
	Finance	Health	Hotel	Retail	Whole-sale	Trans./ Utilities
Australia	41.0		27.3	7.9	9.1	
Canada	45.0	2.3	67.8	12.0	16.0	36.5
Chile	55.0			21.3	27.9	46.8
China	34.0		77.5	24.4	25.5	46.9
EU	52.0	22.3	23.7	23.6	19.9	32.6
Hong Kong	25.0		31.3	10.1	6.9	31.0
Indonesia	54.0		68.2	26.4	24.8	45.3
Japan	41.0	40.1	27.2	32.9	15.6	20.6
Korea				26.7	14.9	31.2
Malaysia	28.0	24.3	38.7	11.2	10.8	30.7
Mexico	33.0		49.6	28.4	25.0	51.0
NZ	58.0		26.9	6.6	19.7	35.6
Philippines	54.0		55.8	43.9	40.3	42.3
Singapore	46.0	29.2	28.2	5.4	7.9	28.0
Taiwan	65.0		74.5	21.5	23.2	38.9
Thailand	60.0	40.6	55.5	44.2	25.6	56.7
U.S.	56.0	37.0	48.5	34.6	27.0	43.4
Other Cairns	70.0	29.3	64.6	24.2	22.9	52.4

Source: Hoekman (2000) Table 4.

Table 19. Changes in Economic Welfare from an Open Club among Airlines in Five Countries (In millions of Australian dollars)

	Scenario One	Scenario Two	Scenario Three
Club members			
Profit (gross)	-38.4	15.6	-30.4
Consumer surplus	291.6	152.1	73.2
Economic welfare	253.2	167.6	42.8
Non-club members			
Profit (gross)	- 29.7	- 24.7	- 4.3
Consumer surplus	23.4	24.3	- 0.3
Economic welfare	- 6.3	- 0.4	- 4.6

Source: Johnson et al (2001) Table 8.9.

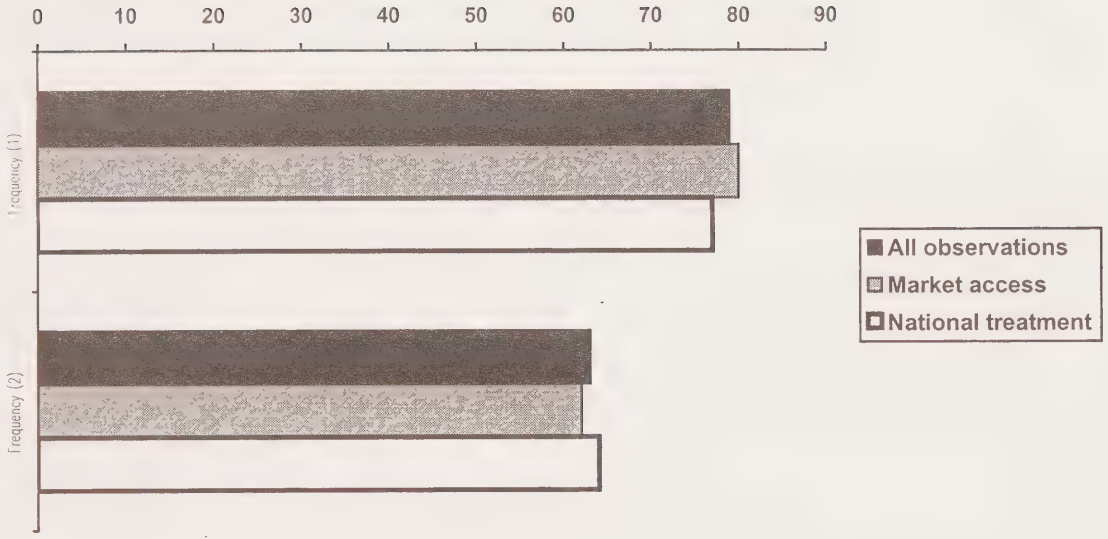


Figure 1. Average frequency measures for 16 APEC countries (Source: PECC 1995)

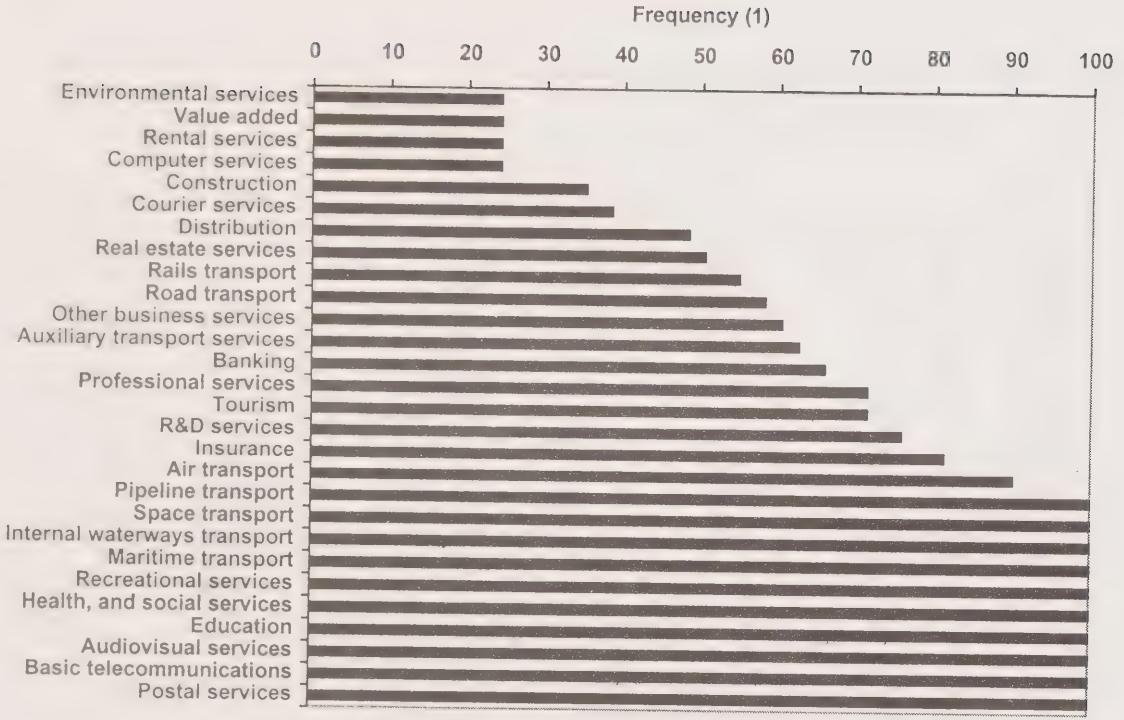


Figure 2. Frequency measures for Canada (Source: PECC 1995)

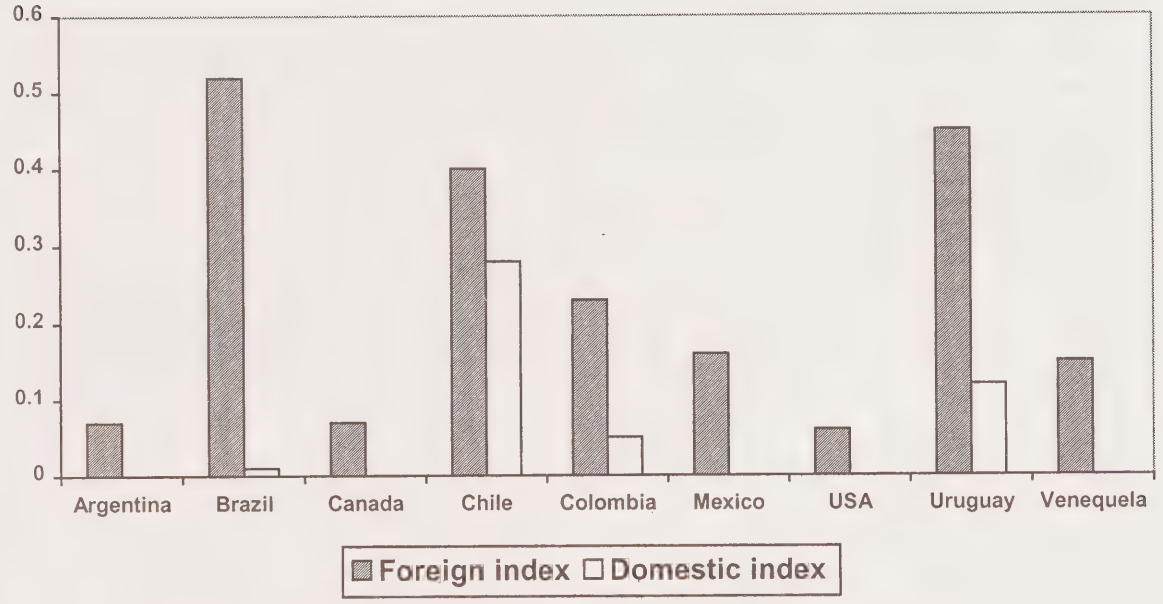


Figure 3. Restrictiveness indices for banking (Source: McGuire and Schuele 2001)

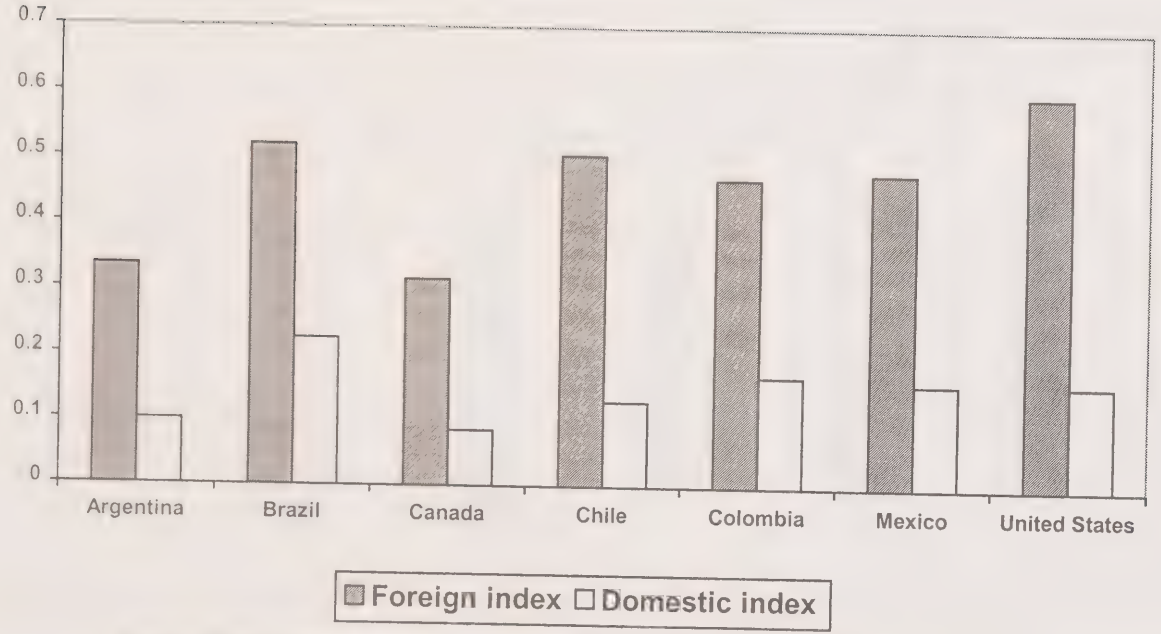


Figure 4. Restrictiveness indices for maritime transport (Source: McGuire et al 2001)

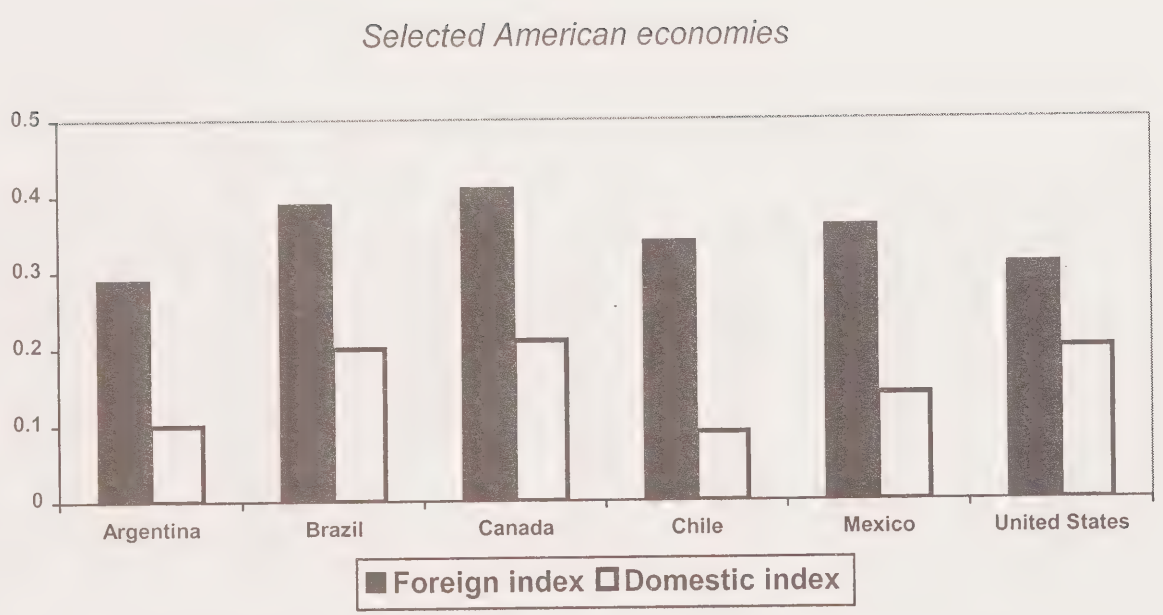


Figure 5. Restrictiveness indices for accountancy services (Source: Nguyen-Hong 2000)

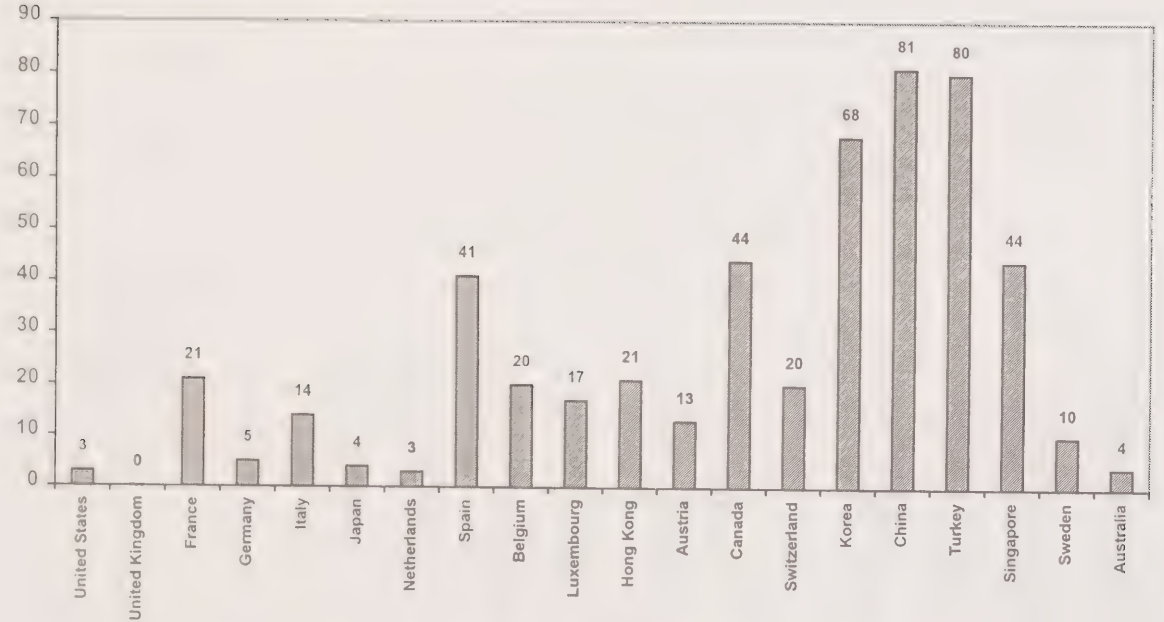


Figure 6. Openness to trade in telecommunications services (Source: Warren 2001a)

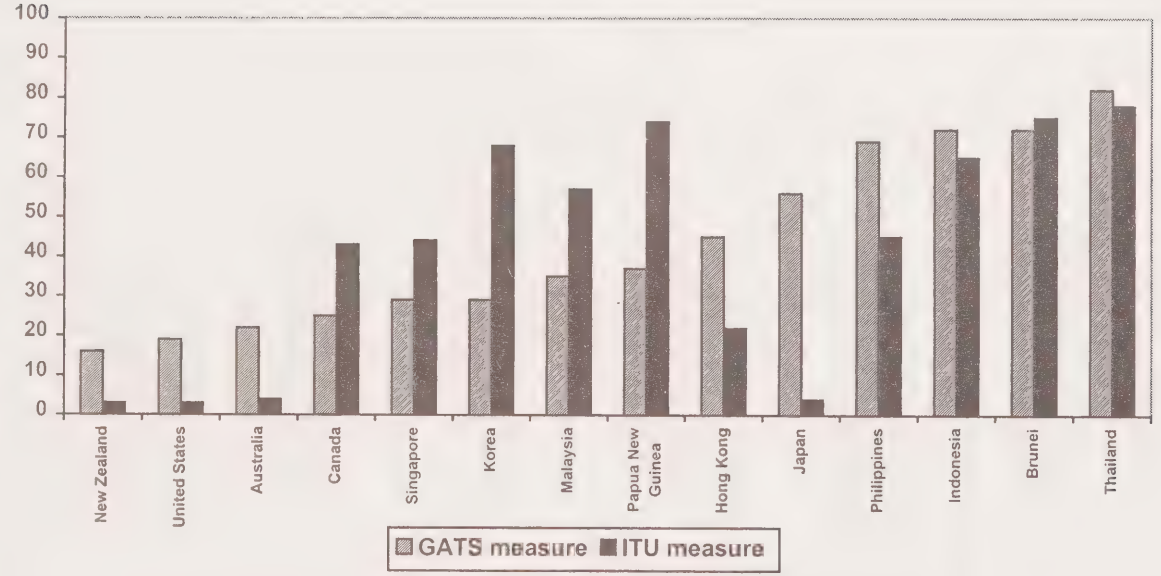


Figure 7. Comparison of ITU measures and GATS measures for telecommunications services (Source: Warren 2001a)

Bibliography

Australian Department of Foreign Affairs and Trade (1999) "Global Trade Reform: Maintaining Momentum," Canberra.

Benjamin, Nancy and Xinshen Diao, "Liberalizing Services Trade in APEC: A General Equilibrium Analysis with Imperfect Competition." *Pacific Economic Review* 5(1). (2000): 49-75.

Betancourt, Roger R. and David A. Gautschi (1993) "The Output of Retail Activities: Concepts, Measurement and Evidence from U.S. Census Data" *Review of Economics and Statistics*, 75(2): 294-304.

Brown, Drusilla K. and Robert M. Stern (2000) "Measurement and Modelling of the Economic Effects of Trade and Investment Barriers in Services," Discussion Paper No. 453, School of Public Policy, University of Michigan.

Brown, Drusilla K., Alan V. Deardorff, and Robert M. Stern. "Modeling Multilateral Liberalization in Services," *Asia-Pacific Economic Review* 2 (1996): 21-34.

Chadha, Rajesh "GATS and the Developing Countries: A Case Study of India," in Robert M. Stern (ed.) *Services in the International Economy*, University of Michigan Press, 2000.

Chadha, Rajesh, Drusilla K. Brown, Alan V. Deardorff and Robert M. Stern, "Computational Analysis of the Impact on India of the Uruguay Round and the Forthcoming WTO Trade negotiations," Discussion Paper No. 459, School of Public Policy, University of Michigan, 2000.

Claessens, Stijn and Tom Glaessner (1998) "Internationalization of Financial Services in Asia" World Bank http://www.worldbank.org/research/interest/confs/past/may10/claeglae.pdf

Deardorff, Alan V. and Robert M. Stern (1998) *Measurement of Nontariff Barriers*, Ann Arbor: University of Michigan Press.

Dee, Philippa, Kevin Hanslow and Tien Phamduv (2000) "Measuring the Cost of Barriers to Trade in Services," manuscript, Australian Productivity Commission http://www.pc.gov.au/research/confproc/abros/paper15.pdf

Dee, Philippa and Kevin Hanslow (2000a) "Multilateral Liberalisation of Services Trade," Productivity Commission Staff Research Paper, Ausinfo, Canberra.

Dee Philippa and Kevin Hanslow (2000b) "Modelling the Liberalisation of Services," manuscript.

Francois, Joseph F.. and Bernard Hoekman (1999) "Market Access in the Service Sectors," manuscript, Tinbergen Institute.

Findlay, Christopher and Tony Warren (2001) "Introduction," in Christopher Findlay and Tony Warren (eds), *Impediments to Trade in Services: Measurement and Policy Implications*, New York: Routledge.

Hardin, Alexis and Leanne Holmes (1997), "Services Trade and Foreign Direct Investment," Staff Research Paper, Industry Commission. Canberra: Australian Government Publishing Services.

Hertel, Thomas, Joseph F. Francois and Will Martin (1999), "Agriculture and Non-agricultural Liberalisation in the Millennium Round," Paper presented at the Global Conference on Agriculture and the New Trade Agenda from a Development Perspective; Interests and Options in the WTO 2000 Negotiations, sponsored by the World Bank and WTO, Geneva, October 1-2.

Hill, T. P., "On Goods and Services," *Review of Income and Wealth*, 23 (1977): 315-338

Hoekman, Bernard (1995), "Assessing the General Agreement on Trade in Services," in Will Martin and L. Alan Winters (eds) *The Uruguay Round and the Developing Economies*, World Bank Discussion Paper No. 307. Washington, D.C.

Hoekman, Bernard (2000) "The Next Round of Services Negotiations: Identifying Priorities and Options," *Federal Reserve Bank at St. Louis Review*, July/August 2000

Hoekman, Bernard and C. Primo Braga (1997) "Protection and Trade in Services: A Survey," The World Bank Policy Research Working Paper 1747.

Johnson, M., Tendai Gregan, Paul Belin, and Geraldine Gentle (2001), "Modelling the impact of regulatory reform," in Christopher Findlay and Tony Warren (eds), *Impediments to Trade in Services: Measurement and Policy Implications*, New York: Routledge.

Kalirajan, Kaleeswaran (2000), "Restrictions on Trade in Distribution Services," Productivity Commission Staff Research Paper, Ausinfo, Canberra.

Kalirajan, Kaleeswaran, Greg McGuire, Duc Nguyen-Hong and Michael Schuele (2001), "The Price Impact of Restrictions on Banking Services," in Christopher Findlay and Tony Warren (eds.) *Impediments to Trade in Services: Measurement and Policy Implications*, New York: Routledge

Kang (2001) "Price Impact of Restrictions on Maritime Transport Services," in Christopher Findlay and Tony Warren (eds.) *Impediments to Trade in Services: Measurement and Policy Implications*, New York: Routledge

Kemp, S. (2001) "Trade in Education Services and the Impacts of Barriers to Trade," in Christopher Findlay and Tony Warren (eds.) *Impediments to Trade in Services: Measurement and Policy Implications*, New York: Routledge.

Laird, Sam (1996) "Quantifying Commercial Policies," in Joseph F. Francois and Kenneth A. Reinert (eds.) *Applied Method for Trade Policy Analysis*, New York: Cambridge University Press.

McDougall, Robert (2000), "International Services Trade Data for CGE Modellers, or, Entropy Methods for Data Reduction," Paper presented at the Third Annual Conference on Global Economic Analysis in Melbourne, Australia, June 27-30, 2000.

McGuire, Greg (2000) "Measuring and Modelling Restrictions on Trade in Services," notes submitted by the Australian Productivity Commission to the OECD.

McGuire, Greg and Michael Schuele (2001), "Restrictiveness of International Trade in Banking Services," in Christopher Findlay and Tony Warren (eds.), *Impediments to Trade in Services: Measurement and Policy Implications.* New York: Routledge.

McGuire, Greg, Michael Schuele and Tina Smith (2001), "Restrictiveness of International Trade in Maritime Services," in Christopher Findlay and Tony Warren (eds.), *Impediments to Trade in Services: Measurement and Policy Implication.* New York: Routledge.

Marko, Mary (1998) "An Evaluation of the Basic Telecommunications Service Agreement," Policy Discussion Paper No. 98/09, Centre for International Economic Studies, University of Adelaide, Australia.

Mattoo, Aaditya (1998) "Financial Services and the World Trade Organization: Liberalization Commitments of the Developing and Transitional Economies," manuscript, World Bank.

Mueller, Dennis C. (1986) *Profits in the Long Run*, New York: Cambridge University Press.

NGMTS (Negotiating Group on Maritime Transport Services) (1994) Questionnaire on Maritime Transport Services – Note by Secretariat: S/NGMTS/W/2, October 21.

Neven, Damien J. "Evaluating the Effects of Non-Tariff Barriers: The Economic Analysis of Protection in WTO Disputes," http://www.worldbank.org/research/trade/conference/neven.pdf

Nguyen-Hong, Duc (2000) "Restrictions on Trade in Professional Services," Productivity Commission Staff Research Paper, Ausinfo, Canberra.

OECD (1997) "Assessing Barriers to Trade in Services: A Pilot Study on Accountancy Services," TD/TC/WP(97)26, Working Party of the Trade Committee. Paris: OECD.

OECD (2000) "Quantification of Costs to National Welfare from Barriers to Services Trade: A Literature Review" TD/TC/WP(2000)24.

Pacific Economic Cooperation Council (PECC) (1995) *Survey of Impediments to Trade and Investment in the APEC Region*, Singapore: PECC.

Robinson, Sherman, Zhi Wang and Will Martin (1999), "Capturing the Implications of Services Trade Liberalisation," Invited Paper at the Second Annual Conference on Global Economic Analysis, Ebberuk, Denmark, June 20-22.

Ross, Thomas W. (1999) "Barriers to Entry," in R. Shyam Khemani (ed.) *A Framework for the Design and Implementation of Competition Law and Policy*, Paris: OECD.

Sampson, Gary and Richard H. Snape (1985) "Identifying Issues in Trade in Services," *The World Economy*, 8: 171-182.

Saunders, Anthony and Liliana Schumacher (1997) *The Determinants of Bank Interest Rate Margins: An International Study*, Washington D.C.: George Washington University.

Tamms, Vanessa (2001), "Frontier Cost Estimates of the Impact of Restrictions on Trade in Air Transport Services," in Christopher Findlay and Tony Warren (eds), *Impediments to Trade in Services: Measurement and Policy Implication*s, New York: Routledge.

Trewin, Ray (2001) "A Price-Impact Measure of Impediments to Trade in Telecommunications Services," in Christopher Findlay and Tony Warren (eds), *Impediments to Trade in Services: Measurement and Policy Implications*, New York: Routledge.

UNCTAD and the World Bank (1994) *Liberalizing International Transactions in Services: A Handbook*, New York: United Nations.

Verikios, George and Kevin Hanslow (1999), "Modelling the Effects of Implementing the Uruguay Round: A Comparison Using the GTAP Model under Alternative Treatments of International Capital Mobility," presented at Second Annual

Conference on Global Economic Analysis, Ebberuk, Denmark, June 20-22, 1999.

Verikios, George and Xiao-guang Zhang (2000), "Sectoral Impact of Liberalising Trade in Services," paper presented to the Third Conference on Global Economic Analysis, Melbourne, June 27-30. http://www.monash.edu.au/policy/conf/53Verikios.pdf

Warren, Tony (2001a), "The identification of impediments to trade and investment in telecommunications services," in Christopher Findlay and Tony Warren (eds), *Impediments to Trade in Services: Measurement and Policy Implications*, New York: Routledge.

Warren, Tony (2001b), "The impact on output of impediments to trade and investment in telecommunications services," in Christopher Findlay and Tony Warren (eds), *Impediments to Trade in Services: Measurement and Policy Implications*, New York: Routledge.

Trade and Investment in Canada's Services Sector: Performance and Prospects

Shenjie Chen*

Introduction

It is commonly known that the services sector has been growing as a share of GDP in most industrialized economies, Canada being no exception. The role that trade and investment have played in this is less well known. Nor, by the same token, is there a widespread understanding of the prospects for gains from additional trade in services that might be achieved through liberalization in the round of multilateral trade negotiations launched at Doha in November 2001.

This chapter seeks to at least partly fill this gap. It reviews the secular rise in importance of the services sector in Canada's economy in recent decades and examines, on an industry-by-industry basis, the role that trade and investment play in these industries.

To provide a comprehensive picture of Canada's trade in services, it pulls together such statistics as are available on all four modes of services trade under the WTO's General Agreement on Trade in Services (GATS): cross-border trade, consumption abroad, commercial presence and movement of natural persons. This review establishes that services trade is already more significant than commonly thought.

* Shenjie Chen is an economist with the Trade and Economic Analysis Division, Department of Foreign Affairs and International Trade. This paper was prepared in a personal capacity. The views are those of the author and are not to be attributed to the Department of Foreign Affairs and International Trade or to the Government of Canada.

The chapter considers the implications of further liberalization and how it might impact on Canada's economy. It shows that trade and investment liberalization is likely to facilitate the structural adjustment toward a knowledge-based economy. Since knowledge-intensive sectors tend to offer more highly paid jobs for well-educated knowledge workers than do other sectors, liberalizing international trade and investment in services is likely to promote the creation of high-quality jobs that enhance the standard of living in Canada.

The secular rise in the services share of output

A pronounced secular rise in the services sector's share of GDP is a standard feature of the evolution of economies from rural agricultural to urban industrialized. For Canada, the structural shift toward a services-dominated economy is best shown by Canada's changing employment pattern over the decades, as shown in Table 1.

Table 1. Canada's Sector Shares of Employment (percent)

	Agriculture	Other resources	Mfg.	Construction and utilities	Services	Industry unspecified
1891	45.7	n/a	n/a	n/a	n/a	n/a
1911	34.2	5.0	17.4	7.7	32.5	3.2
1921	32.8	4.0	16.7	6.1	36.2	4.3
1931	28.7	4.3	16.9	6.9	38.8	4.3
1941	25.8	5.7	21.9	5.8	39.8	1.1
1951	18.4	4.4	26.5	7.8	42.9	0.0
1961	11.2	3.0	24.0	7.4	54.3	0.0
1971	6.2	2.8	22.2	7.2	61.6	0.0
1981	4.4	2.9	19.3	7.1	66.3	0.0
1991	3.5	2.3	14.7	6.8	72.6	0.0
2000	2.5	1.9	15.3	6.3	74.1	0.0

Sources: Before 1951, *Statistics Canada's Historical Statistics*, Series D8-85. After 1951, *Statistics Canada's Labour Force Survey*.

In the first half of the 20th century, the gains in the services sector went hand in hand with a rise in the manufacturing share in total employment; since the 1950s, the rise in the services

sector's share coincided with a decline in manufacturing's share of employment. The major resource sectors—agriculture, forestry and mining—meanwhile, witnessed a continuation of the decline in their shares from the first half of the century. Table 2 shows the evidence for this structural shift over the postwar period, this time in the GDP accounts.[1]

Table 2. Canada's Sector Shares of GDP (percent)

	Agriculture	Other resources	Mfg.	Construction and utilities	Services
1951	11.8	7.0	29.5	7.2	44.5
1961	4.3	6.2	24.1	10.3	55.1
1971	3.0	5.2	21.8	10.1	59.8
1981	3.0	8.4	18.5	10.9	59.3
1991	1.7	4.6	16.3	10.0	67.3
1997	1.5	5.4	18.9	8.8	65.3

Source: Statistics Canada: Historical Statistics; CANSIM Matrices 4765 and 4766.

In terms of shifts of economic resources, the data on investment paint a broadly similar picture; namely, an increasing weight of the services sector in the share of overall capital formation in the Canadian economy. In the case of this indicator, while this statement holds for the longer term, as shown in Table 3, there is less consistency here, since the services sector's share of the capital stock fell from the 1960s to the 1980s before beginning to expand again. Nonetheless, by the end of the 1990s, it was at an all-time high.

[1] Note: the latest year for which reliable data are available on the services share of GDP is 1997; this reflects the way that the services portion of the National Accounts is compiled. It should be noted that the sectoral shares of GDP tend to be cyclically sensitive: that is, since services tend to be less cyclical than the goods sectors, the services sector's share of GDP tends to be higher during economic slowdowns and to fall back somewhat during economic expansions. Accordingly, care should be taken not to attach too much significance to specific figures in given years.

Table 3: Share of Capital Stock by Sector, in constant 1992 dollars (percent)

	Agriculture	Other Resources	Mfg.	Construction & utilities	Services
1955	9.8	6.3	15.7	11.0	57.1
1961	7.2	8.2	14.7	12.4	57.5
1971	5.7	10.6	14.2	13.5	56.0
1981	5.5	11.9	13.3	15.9	53.4
1991	2.9	10.6	12.9	17.8	55.8
1999	2.3	10.3	11.3	17.6	58.6

Source: Statistics Canada, Catalogue 13-568. Note: The net capital stock is calculated based on the formula of geometrical depreciation.

The data in Tables 1 and 2 (although, interestingly, not Table 3) suggest that the structural shift toward services began to peter out in Canada toward the end of the 20th Century. The services sector's share of GDP was at best flat in the 1990s (the decline recorded between 1991 and 1997 is primarily due to the tendency of the services sector to be higher during cyclical downturns such as in 1991, and to fall back during an upswing such as was in force in 1997). Corroborating evidence for the slowdown is provided by the fact that growth in the sector's share of employment slowed sharply in the 1990s.

Also notable is the gap between the gain since 1971 in the services sector's share of GDP of 5½ percentage points and the gain in the employment share of 12½ percentage points. Taken together with the fact that the services sector also had stronger capital formation than the economy-wide average over this period, this points to either weak productivity performance in this sector or to a decline in the sector's internal terms of trade—or to data problems in measuring the services sector's output.

Since most industrialized countries witnessed a secular increase in the services share of GDP in the last several decades, it is of interest to compare the developments in the more recent period in Canada to those in other advanced industrial countries. As shown in Table 4, Canada stands out in terms of having a comparatively small gain in the services

sector's share of GDP. In part, this reflects the fact that the development of Canada's services sector had advanced further by the beginning of the 1970s than in other G7 economies—as can be seen, the economies that were the most services-intensive in 1971 (i.e. the United States, Canada and the United Kingdom) tended to have smaller increases in the services share of GDP over the reference period than did the least-services-intensive economies such as France and Germany. This strongly suggests a pattern of convergence toward a high share of services in mature industrialized economies. Nonetheless, the fact that Canada's services sector did not do as well as its counterparts in the United States and the United Kingdom is striking.

Table 4. Services as a Share of GDP in G7 Countries (percent)

	1971	1981	1991	1997	Change 1971-1997
U.S.A.***	62.8	62.9	70.1	74.5	11.7
Canada	59.8	59.3	67.3	65.3	5.5
U.K.	55.8*	59.6*	69.4	67.8	12.0
Japan	51.8*	57.9*	61.4*	60.9	9.1
Italy	50.4*	56.0*	62.5	66.7	16.3
France	50.1*	58.4*	64.7*	70.7	20.6
Germany**	44.6*	53*	57.4*	66.6	22.0

Sources: OECD, *Services Statistics on Value Added and Employment*, 1996 and 2001 editions; Bureau of Economic Analysis, U.S. Department of Commerce. Statistics Canada. CANSIM Matrices 4765 and 4766.

* Except for the United States, data marked by * are compiled based on the International Standard Industrial Classification, version 2; otherwise, data are based on version 3.

** Data include West Germany only in the years 1970, 1980 and 1990.

*** Before 1987, all data are compiled based on the U.S. Standard Industrial Classification, 1972 version; after that, data are based on the 1987 version.

The developments in Canada's services sector in the most recent years came in the context of intense trade-policy activism, the most notable events being the negotiation of the Canada-U.S. Free Trade Agreement, and the NAFTA, the conclusion of the Uruguay Round and the coming into force of

the GATS. Accordingly, it is of interest to examine the role of trade and investment in Canada's services industries, on an industry-by-industry basis, to determine what role, if any, trade played in shaping the broad trends described above; and, against that background, to consider the prospects for liberalization of services in the Doha Round.

Canada's Services Trade: Structural Features

General considerations and caveats

Analysis of services trade is more complicated than the situation in goods trade because of the different modes through which services trade can be undertaken. As noted earlier, the General Agreement on Trade in Services (GATS) considers trade in services to be conducted in four modes:

1. services being supplied from one country to another (cross-border trade);
2. consumers or firms making use of a service in another country (consumption abroad);
3. a company setting up a subsidiary in another country (commercial presence); and
4. individuals travelling from their own country to supply services in another (movement of natural persons).

No country has ever constructed a data set to pull together a comprehensive picture of services trade through all four modes and across all sectors. However, by drawing on different sources, such a data set can be roughly approximated.

The services trade statistics in the balance of payments (BOP) capture a large part of services trade through cross-border transactions and consumption abroad; to some extent, they also reflect trade effected through movement of natural persons.[2] However, given the purpose of the BOP accounts to

[2] This being said, the BOP-based data cannot be cleanly broken down into Mode 1, 2 and 4, nor do they provide a complete picture of Mode 4. Mode 2 data (consumption abroad) are available, although the quality is weak as the figures are estimated from the number of visitors and survey

capture flows between countries, they do not capture *any* services trade under GATS Mode 3, the export of services through "commercial presence." This is because a subsidiary that establishes commercial presence is a resident of the country in which it is set up; accordingly, its sales in this territory to the local population are transactions between residents and so escape BOP recording. At the same time, such sales are considered trade in services under the GATS definition.

This gap is being filled by a recently developed statistical domain known as Foreign Affiliates Trade in Services (FATS). The FATS data measure sales of services by affiliates established in foreign countries to local persons and so correspond to the GATS notion of services trade through commercial presence.

Information on Canada's Mode 3 services imports is available from data on the operations of foreign majority-owned firms in Canada; these data include sales, employment and value-added by multinational firms. However, to obtain information on Canada's Mode 3 services exports, we have to turn to foreign sources. Here, the only data that are readily available are those published by the U.S. Department of Commerce on sales to U.S. residents by the U.S. affiliates of Canadian companies. Given the significance of the United States for Canadian exports, this does, however, give us at least a good partial picture of Canada's Mode 3 services exports.

There are two further complications of note.

First, whereas the FATS data are compiled according to the Standard Industrial Classification (SIC), the BOP data are recorded on the basis of type of service. This difficulty can be circumvented, however, by drawing on the input-output tables compiled by Statistics Canada.[3] The input-output (I-O) data are

---

data on expenditure patterns of visitors. However, insofar as information on sales through Mode 4 (sales by movement of natural persons to the foreign country) are recorded at all, they are not separated from records of sales on a cross-border basis.

[3] Statistics Canada, "The Input-Output Structure of the Canadian Economy 1961-1981," Catalogue No. 15-510.

derived from the BOP data and thus capture, to varying degrees, trade through Modes 1, 2 and 4. However, since I-O data are converted to the same SIC basis as the FATS statistics, they allow direct comparisons of commercial presence and cross-border trade.[4]

Second, given the data sources, we are constrained to a fairly short period for analysis. On the one hand, the FATS data do not go back very far in time (for imports, they reach back only to 1986 and, for exports to the United States, they miss the important banking sector and go back only to 1989). On the other hand, the I-O data only appear with a considerable lag after the BOP data are published; accordingly, the latest year for which data are available is 1997.

This analysis thus is carried out within rather difficult constraints; nonetheless, some interesting observations on Canada's trade and investment in services can be obtained.

---

[4] One complication in the I-O data is that they attribute some portion of the value of merchandise exports to the services account. This reflects the valuation basis on which I-O goods data are calculated. In the I-O framework, output is valued at producers' prices (or factory-gate prices). The value of goods exports in the BOP accounts, however, is on a "free on board" or f.o.b. basis—that is, the value of the goods at the port of exit, including domestic freight, insurance and other associated services costs charged to that point. In the I-O framework, the difference between factory-gate and f.o.b. values is treated as a "transportation margin" and attributed to the transportation sector. Thus, while total exports of goods and services in the input-output account match the balance of payments totals, there is a shift from the merchandise account to the service account of that portion of the value that represents these transportation margins. A similar effect occurs in the wholesale and retail trade sectors. In the I-O framework, wholesale and retail "margins" associated with goods trade are imputed to these sectors as services exports. On the other hand, the valuation of imports is taken at the Canadian border. As a result, I-O-based merchandise imports are greater than BOP-based merchandise imports, while I-O-based services imports are smaller than BOP-based imports. For a detailed discussion of this issue, see Statistics Canada's "*The Input-Output Structure of the Canadian Economy, 1961-1981*", Catalogue 15-510.

Overall performance in services trade

Based on BOP data, Canada's total services exports under GATS Modes 1, 2 and 4, insofar as the BOP data capture trade under these various modes, amounted to $55.3 billion in 2000, or 5.2 percent of GDP. For imports, the corresponding figure was $62 billion or 5.9 percent of GDP. Generally speaking, the services trade share of GDP has been rising, but not as fast as that of merchandise trade; accordingly, the share of services trade in overall trade in goods and services has actually tended to decline (See Table 5).

Table 5: Canada's Services Trade as a Share of GDP and Total Trade (percent), Balance of Payments Basis

Year	Services exports/GDP	Services imports/GDP	Services exports/Total exports	Services imports/Total imports
1951	2.9	3.5	12.8	14.9
1961	2.4	3.7	13.9	20.2
1971	2.7	3.7	12.7	18.7
1981	2.8	4.0	10.5	15.3
1991	3.4	5.1	13.6	19.8
2000	5.2	5.9	11.6	14.6

Source: Statistics Canada, *Canadian Economic Observer: Historical Statistical Supplement.*

This is, of course, an incomplete picture of services trade based on GATS definitions. Just how incomplete it is becomes evident when we integrate the information on Mode 3 trade. In 1997, Canadians purchased $126.7 billion of private services from majority-owned Canadian affiliates of foreign firms, *2.4 times* the value of Canada's cross-border imports of $52.6 billion from the world. While the data on Canadian services exports through Mode 3 are only partial, the story is quite similar. In 1997, the affiliates of Canadian service firms in the United States sold $48.5 billion of non-banking private services to U.S. customers, *2.1 times* the value of Canada's cross-border services exports to the United States of $22.7 billion in the same year, based on BOP data. Since services exports to countries

other than the United States are likely to be even more dependent on Mode 3 (not least because travel costs and time zone differences would make other modes less attractive when dealing with customers in Europe and the Far East), the ratio of Mode 3 exports to cross-border exports probably lies above the 2.1 figure obtained for private non-banking services into the United States, and, indeed, it is open to speculation whether this ratio would approach the 2.4 ratio observed for services imports.

These data, however incomplete, provide the basis for a rough assessment of the overall size of Canada's services trade through the four GATS modes, as shown in Table 6. A range for global Mode 3 services exports is provided based on the ratios of 2.1 and 2.4 discussed above

Table 6: Canada's Overall Services Trade through the Four GATS modes, 1997 (C$ billions)

	Modes 1, 2 and 4	Mode 3	Total
Exports	43.8	92.0 – 105.0	135.8 – 148.8
Imports	52.6	126.7	179.3
Balance	-8.8	-34.7 – -21.7	-43.5 – -30.5

Sources: The U.S. Department of Commerce, the Bureau of Economic Analysis, Statistics Canada

As can be seen, the value of overall services trade in 1997, which may be estimated to be upwards of C$315 billion, was several times larger than the figure of C$96.4 billion obtained from the BOP data. This demonstrates that Mode 3 is actually, by far, the preferred mode for services trade; *ipso facto*, the usual measures of services trade from the BOP data that exclude Mode 3 sales vastly understate the importance of services trade, as understood in the GATS.

Insofar as the above data and estimates can be relied on, Canada would appear to have been in a deficit position on trade in services across the 4 modes of trade in 1997. Thus, there is *prima facie* support for the possibility that Canada lacks a comparative advantage in services trade.

However, this does not necessarily lead to the conclusion that Canada's services sector would lose under international trade and investment liberalization. This reflects the fact that, between industrialized countries, trade appears to be motivated far more by product differentiation at the firm level.[5] Moreover, as will be discussed below, there is a wide range of services industries. In a qualitative sense, what matters is whether Canada will do well in the types of high-quality, knowledge-intensive services that offer well-paying jobs. Finally, there is the possibility that the deeper liberalization that took place in the goods sectors, particularly through the Canada-U.S. FTA and the NAFTA, as well as in foreign direct investment, resulted in less cross-border services trade suffering.[6] In other words, liberalizing services to match the liberalization that has already taken place in the goods trade may restore the sector's internal competitiveness.

To get at these issues, we must look at the export performance of Canada's services industry by sector.

---

[5] There are two main trade theories on differentiated products. One is based on the assumption of imperfect competition and increasing returns to scale. For a detailed description of this theory, see: Paul Krugman (1980), "Scale Economics, Product Differentiation, and the Pattern of Trade," *American Economic Review* 70:950-959; and Elhanan Helpman and Paul Krugman (1985), *Market Structure and Foreign Trade: Increasing Returns, Imperfect Competition, and the International Trade* (Cambridge, M.A.: MIT Press, 1985). The second theory is based on the assumption of constant returns to scale with internationally identical but not homothetic consumer preference. See Bergstrand, Jeffrey H. (1990) "The Heckscher-Ohlin-Samuelson Model, the Linder Hypothesis and the Determinants of Bilateral Intra-Industry Trade," *Economic Journal* 100, (December), pp. 1216-1229, and Alan Deardorff, "Determinants of Bilateral Trade: Does Gravity Work in a Neoclassical World?" NBER Working Paper Series 5377, 1995.

[6] The possibility that partial liberalization can hurt a particular sector is demonstrated elsewhere in the present volume in Brian R. Copeland, "Benefits and Costs of Trade and Investment Liberalization in Services: Implications from Trade Theory."

To examine Canada's services sector's trade on an industry-by-industry basis, we rely in the first instance on the input-output data set, which provides an industry breakdown of BOP accounts.[7] For analytical purposes, we regroup some of the industrial groupings in the input-output table. The main emphasis is on determining how Canada appears to be doing in the knowledge-intensive sectors versus those that are less knowledge-intensive.

In the discussion below, we will refer to "cross-border trade" as all sales captured by the input-output accounts, which, as discussed earlier, covers Mode 1 (cross-border), Mode 2 (consumption abroad) and perhaps some part of Mode 4 (movement of natural persons in their capacity as suppliers, insofar as these transactions result in flows recorded in the BOP accounts). Meanwhile, "affiliate sales" refers to Mode 3 (commercial presence) activity.

Business services

Business services comprise computer-related, accounting, legal, architectural, engineering and advertising services. Services in these categories provide the kinds of jobs that would normally be considered "knowledge-intensive," requiring post-secondary degrees. Since Canada has one of the world's most highly educated workforces, it would be reasonable to expect good performance in trade in these sectors; moreover, Canada *needs* to perform well in these areas to preserve a spot among the best-performing economies in the world.

---

[7] As discussed earlier, it is not appropriate to use this data set to draw conclusions as to whether the *balance* of trade in the services sector is in Canada's favour or not. This reflects the fact that (a) the input-output data use factory-gate valuation for exports but at-the-border valuation for imports; and (b) transportation margins are included in services exports but not in services imports. At the industry level, small differences between imports and exports therefore should not be ascribed much meaning.

In 1997, Canada exported $9.74 billion of business services and imported an equivalent amount of $9.76 billion from the rest of the world. However, over the reference period (1986-1997), export growth (14.3 percent) far outstripped import growth (8.7 percent). This growth performance is a particularly important indicator in terms of how we view Canada's competitive position in knowledge-intensive services trade.

Table 7. Cross-Border Trade by Industry: Business Services (C$ millions)

	1986	1997	Annual average growth (%)	1986	1997	Annual average growth (%)
	Exports			Imports		
Total	2,243	9,737	14.3	3,912	9,759	8.7
▪ Computer & related	234	1,931	21.2	182	1,353	20.0
▪ Accounting & legal	60	358	17.6	84	523	18.1
▪ Arch., eng., & science	1,151	4,834	13.9	2,266	4,364	6.1
▪ Advertising	46	252	16.7	242	489	6.6
▪ Miscellaneous	752	2,362	11.0	1,138	3,030	9.3

Source: Appendix Table A1.

Architecture, engineering and scientific R&D) services is the most important industry segment for cross-border trade with annual exports and imports equal to $4.8 billion and $4.4 billion, respectively, in 1997. Between 1986 and 1997, Canada's exports of these services grew at an annual average growth rate of 13.9 percent, more than twice as fast as import growth of 6.1 percent over the same period.

Two-way trade in computer and related services also grew rapidly in the reference period; this, of course, is scarcely surprising in the context of the global information technology boom that characterized this period. Between 1986 and 1997, Canada's exports of computer services grew at an annual rate of 21.2 percent, increasing to $1.9 billion in 1997 from $234 million in 1986. Similarly, imports increased to $1.4 billion in 1997 from $182 million in 1986, reflecting an average annual growth rate over the reference period of 20 percent.

Canada's balance in both advertising, and accounting and legal services, was substantially negative in the reference period, but growth of exports was strong. In 1997, Canada exported $252 million of advertising services abroad and imported $489 million; however, export growth over the reference period was 16.7 percent versus only 6.6 percent for imports. In the same year, Canada exported $358 million of accounting and legal services, and imported $523 million. Export growth was also very strong in this sector (17.6 percent), although falling just short of the growth rate of imports in this sector (18.1 percent).

By contrast, Mode 3 trade in business services has been smaller, and exports, although growing strongly, fall well short of imports.

Table 8. Mode 3 Exports by Industry: (United States only): Business Services (C$ millions)

	1989	1998	Growth (%)
Total business services	394	1170	12.8
Computer & data-processing services	173	590	14.6
Information services & data processing	n/a	12	N/a
Computer-systems design & related services	n/a	578	N/a
Accounting, research, management & related services	18	206	31.3
Accounting, tax preparation, payroll & legal services	n/a	0	N/a
Management, scientific & technical consulting	n/a	7	N/a
Scientific research & development services	n/a	199	N/a
Engineering, architectural & surveying services	197	265	3.4
Architectural, engineering & related services	n/a	215	N/a
Other professional, scientific & technical services	n/a	50	N/a
Advertising	7	108	35.3

Source: Appendix Table A2.

Whereas the C$1.2 billion of business services sold by Canadian affiliates in the United States in 1998 represented only 12 percent of the value of cross-border exports of these services, Mode 3 imports rivalled cross-border flows in this category; at the same time that import growth was slower than exports.

Insofar as there are any surprises, these lie in the comparatively modest expansion seen in Mode 3 trade in

computer services. While the data for 1997 imports are suppressed for confidentiality reasons, one can infer that growth in this sector was no higher than 4.5 percent (if advertising and other services registered, in fact, zero sales in 1997)—and probably half that rate given plausible assumptions about advertising and "other" business services sales that year.

Table 9: Mode 3 Imports by Industry: Business Services (C$ millions)

	1988		1997		
	Revenue	Industry share (%)	Revenue	Industry share (%)	Average growth (%)
Total business services	5,118	22.6	8,511	17.1	5.8
Computer & related	3,503	57.7	n/a	n/a	n/a
Accountant & manager	684	11.6	2,113	12.4	13.4
Offices of engineers	321	7.7	1,204	14.5	15.8
Advertising services	216	11.0	n/a	n/a	n/a
Other	394	n/a	n/a	n/a	n/a

Source: Appendix Table A3.

There are several reasons to be cautious about drawing conclusions about the computer and related services industry, however. First, this industry has been in a state of flux with rapid growth followed by a bust, and, through it all, a wave of mergers and acquisitions activity, much of it on a cross-border basis, has changed the face of the industry quite dramatically. Thus, in 1994, the last year for which data are available on Mode 3 imports of computer and related services, the revenue figures were far higher than in 1997.[8] Since cross-border merger and acquisition activity continued to be extraordinarily strong well into 2000, it is to be anticipated that the affiliate sales figures have become far larger than the 1997 data indicate.

[8] Revenue of foreign affiliates in Canada's computer-services industry totalled $9.7 billion in 1994, accounting for 70 percent of total sales of computer services in Canada. This was the highest level of foreign commercial presence in Canada of all service industries

The large commercial presence of foreign-owned computer services firms in Canada, in the context of an industry in which cross-border trade was also growing by leaps and bounds, strongly suggests that multinational enterprises chose to deliver services from Canadian establishments so as to take advantage of Canada's low-cost but highly educated labour force.

On balance, the data on trade in business services is highly encouraging in terms of the prospects for Canada reaping benefits from further liberalization in these knowledge-intensive industries.

Finance, insurance and real estate

There is a substantial amount of cross-border trade in finance, insurance and real estate services; however, due to regulatory requirements, there is substantially more on a Mode 3 basis.

In 1997, Canada exported $6.7 billion and imported $8.5 billion of financial services from the world on a cross-border basis. Growth in exports modestly outpaced import growth.

Table 10. Cross-Border Trade by Industry: Finance, Insurance and Real Estate (C$ millions)

	1986	1997	Annual average growth (%)	1986	1997	Annual average growth (%)
	Exports			Imports		
Total	2,770	6,710	8.4	3,753	8,525	7.7
▪ Deposit-takers*	1,227	2,130	5.1	595	1,820	10.7
▪ Other finance	389	1,056	9.5	1,773	2,119	1.6
▪ Insurance	1,061	3,057	10.1	1,303	4,371	11.6
▪ Real estate	93	467	15.8	82	215	9.2

Source: Appendix Table A1. * Deposit-taking institutions include banks, other deposit-taking intermediaries and credit unions.

Insurance is the largest and fastest-growing financial-services sector in cross-border trade. In 1997, Canada's exports of insurance services grew at a respectable annual rate of 10.1

percent, reaching $3.1 billion in 1997 from $1.1 billion in 1986. Imports of insurance services totalled $4.4 billion, having increased at an annual rate of 11.6 percent from $1.3 billion in 1986. Both export and import growth were largely due to reinsurance business. This is because there are no regulatory impediments to international reinsurance; rather, international diversification of risk through reinsurance underpins the soundness of the global insurance market.

Also noteworthy is the fast growth of exports of "other financial services," relative to imports. This category includes securities-related activities, including fund management.

The vast majority of financial services trade takes place, however, through affiliate sales; this largely reflects regulatory requirements aimed at allowing domestic regulators to supervise the activities of financial institutions in the interests of local depositors and insurance policyholders—and, in the event of solvency problems, to seize the assets of the companies.

Canada's commercial presence in the U.S. financial services market is large as shown in Table 11.

Table 11. Mode 3 Exports to the United States by Industry: Finance, Insurance and Real Estate (C$ millions)

	1989	1998	Annual average growth (%)
Total	15,639	27,907	6.6
Finance, except banking	230	4,486	39.1
▪ Non-depository credit intermediation and related services	n/a	1,692	n/a
▪ Securities, commodity contracts & related activities	n/a	2,794	n/a
Insurance	10,479	15,406	4.4
Real estate	4,930	3,528	-3.6

Source: Appendix Table A2.

As can be seen, affiliates of Canadian insurers sold $15.4 billion of insurance services in the United States in 1998. As well, Canadian affiliates rang up $4.5 billion of non-banking financial services. Sales of these two types of services by

Canadian firms represented 16 and 20 percent of total affiliate sales by foreign firms in the U.S. market, respectively.

Comparable figures are not available for the banking sector. However, Canadian banks have been active in the United States and other foreign markets: 46 percent or C$4.5 billion of the earnings of the Canadian banks in 2000 came from operations abroad, much of this through commercial presence. The situation in this sector has changed rapidly in recent years, since the major Canadian banks made acquisitions in the United States alone during 2000 worth about C$1.3 billion. Accordingly, the above figures undoubtedly considerably understate Canadian Mode 3 exports to the United States, let alone to the world.

Mode 3 imports are also substantial. In 1998, Canadians bought $44 billion worth of financial services from affiliates of foreign-owned firms established in Canada, far greater than cross-border imports of similar services of $8.3 billion.

Table 12: Mode 3 Imports by Industry: Finance, Insurance and Real Estate (C$ millions)

	1988		1997		
	Revenue	Industry share (%)	Revenue	Industry share (%)	Annual average growth (%)
Finance, insurance & real estate	24,664		38,763		5.2
Finance & insurance	29,067	23.8	43,990	25.7	4.7
Chartered banks	3,581	10.2	4,058	6.8	1.4
Financial leasing	n/a	n/a	237	21.7	n/a
Other financial intermediaries	3,455	54.2	7,853	63.2	9.6
Other mortgage intermediaries	n/a	n/a	84	3.0	n/a
Life insurers	7,620	28.8	9,875	27.7	2.9
Property & casualty insurers	9,064	62.0	14,965	59.3	5.7
Insurance agents & brokers	348	11.4	637	8.1	6.9
Brokerage & other services	596	13.0	1,054	16.2	6.5
Real estate	1,681	8.0	2,586	11.9	4.9
Real estate operators	1,643	10.8	2,532	12.3	4.9
Real estate agents & brokers	38	0.7	54	5.2	4.0

Source: Appendix Table A3.

Insurance represented the largest component of total affiliate sales in financial services, with the sales of life and non-life insurance amounting to $9.9 billion and $15 billion, respectively, in 1997. The latter figure represented 59.2 percent of total sales of non-life insurance in Canada. This reflects the historic dominance of Canada's property and casualty insurance sector by branches or subsidiaries of foreign firms.

Foreign commercial presence in Canadian banking services was relatively weak, representing only 6.8 percent of total sales of banking services in Canada. The low level of foreign commercial presence in the Canadian banking sector is thought by many to reflect Canada's restrictions on foreign ownership in the banking sector. However, it is more likely to reflect the difficulties of expanding market share in a mature industry through internal growth. In point of fact, since the Canada-U.S. FTA, U.S. banks have not been subject to the limit imposed on the foreign bank share of Canadian banking-system assets.

When it comes to trade liberalization, there are few sectors that are more "sensitive" than financial services. This reflects a number of considerations. First, financial institutions serve the vital function of channelling savings into investments. A strong financial sector is generally thought to be essential to the health of the economy overall. Since the experience within national markets shows that financial services are subject to very powerful agglomeration pressures (e.g. within national economies, particular cities such as New York, London, Tokyo, Frankfurt and, in Canada, Toronto, become the seat for most financial institutions), trade liberalization in this sector raises numerous questions. Furthermore, the over-riding importance of prudential considerations in this sector have led regulatory authorities to require that sufficient capital and assets be maintained within national borders to protect local depositors and policyholders.

Trade performance is, however, also an important consideration in its own right. The above discussion suggests that Canada can hold its own in this field, at least in specific industry segments.

Finally, as regards real-estate services, these are not considered as tradable under the BOP concepts, but it is treated as tradable in the input-output account. Canada's exports and imports of real-estate services totalled $467 million and $215 million, respectively, in 1997.

Canada had a relatively high level of commercial presence in the U.S. real-estate market, amounting to $3.5 billion in 1998, representing 19 percent of total affiliate sales by foreign-owned firms in the United States. However, this represented a steep decline from $4.9 billion in 1989. Affiliate sales of real-estate services by foreign-owned firms in Canada were $2.6 billion in 1997, representing 11.9 percent of total sales of real-estate services in Canada. Between 1988 and 1997, sales of real-estate services by foreign-owned firms in Canada rose modestly at an annual rate of 3.1 percent.

Communications and broadcasting services

Communication and broadcasting services include broadcasting, telecommunications carriers, cable television, and postal and courier services. In 1997, Canada's two-way cross-border trade in this sector totalled $5 billion, with imports of $2.8 billion exceeding exports of $2.2 billion. As shown below, import growth also outpaced export growth over the reference period.

Table 13. Cross-Border Trade by Industry: Communications and Broadcasting Services (C$ millions)

	1986	1997	Annual average growth (%)	1986	1997	Annual average growth (%)
		Exports			Imports	
Total	949	2,169	7.8	889	2,804	11.0
Radio & TV broadcasting	20	71	12.2	46	370	20.9
Cable television	16	22	2.9	11	229	31.8
Telecommunications	716	1,430	6.5	732	1,642	7.6
Postal & courier services	197	646	11.4	100	563	17.0

Source: Appendix Table A1.

A few words are in order, however, about the meaning of some of these data. Cross-border trade statistics in telecommunications services are essentially a product of the "accounting rate system" that is used for calls that are placed in one market and terminate in a foreign market. As bilateral imbalances in international calling traffic occur, the carriers whose outbound calling minutes exceed inbound calling minutes make a net settlement payment to their foreign counterparts. Net settlement payments register as imports in the BOP, whereas net settlement receipts register as exports.[9]

Exports and imports of telecommunications carrier services grew annually by 6.5 percent and 7.6 percent, respectively, over the reference period. These increases mainly reflected the growing long-distance calling volume, as deregulation of communications services in Canada and abroad resulted in lower prices for long-distance calls.

The second most important subsector is postal and courier services. Trade in this subsector increased strongly over the reference period, with exports growing at an average annual rate of 11.3 percent and imports at 17 percent. Rising two-way trade in postal and courier services appears to reflect at least in part the expansion of e-commerce and the increased cross-border transactions of goods and services executed over the Internet. Canadian service providers would appear to be at a significant disadvantage vis-à-vis U.S. competitors, if for no other reason than geography. The major well-known U.S. parcel services have the advantage of locations that are central to North American traffic, whereas Canadian service will, by necessity, be delivered from a home base on the periphery.

Finally, and not very surprisingly, Canada is in a growing deficit position on international trade in radio and television broadcasting, including cable TV. Imports of broadcasting services rose at a robust annual rate of 20.9 percent and cable television services soared at a 31.8 percent rate; exports were modest both in level and growth.

[9] U.S. International Trade Commission (2000) "Recent Trends in U.S. Services Trade," p. 19-1.

Mode 3 is the more interesting mode of international trade in communications and broadcasting. Affiliate transactions in communications services have become increasingly important due to the worldwide trend toward privatization of state-owned monopolies and easing of foreign-ownership restrictions of carriers. Statistics from the U.S. Department of Commerce show that sales of telecommunications and broadcasting services by affiliates of Canadian firms established in the United States totalled C$4.5 billion in 1998, accounting for 21.4 percent of total affiliate sales by foreign-owned firms in the U.S. market. This represented a massive increase from C$44.3 million in 1990 (indeed, the annual rate of growth was 67 percent).

With respect to affiliate sales of telecommunications services in Canada, the latest available statistics show that Canada's Mode 3 imports were $2.8 billion in 1994,[10] accounting for 15.3 percent of Canada's telecommunications carrier services market.

Sales of postal and courier services by foreign-based affiliates surged strongly to more than $1 billion in 1994 from $335.1 million in 1988, an increase of 200 percent.[11] Sales of postal and courier services by foreign-based affiliates accounted for 14.8 percent of total sales in Canada in 1994. Such sales are likely to continue to grow in response to growing e-commerce services in North America.

Motion picture, audio-video and other entertainment services

Despite concerns over the competitiveness of the Canadian cultural industry in facing the competitive pressure from the United States, Canada's trade performance in cultural and entertainment services was quite impressive over the reference

[10] 1994 figures are the latest data available for sales of telecommunications carriers by foreign-owned firms in Canada.

[11] 1994 figures are the latest data available for postal and courier services by foreign-owned firms in Canada

period. In 1997, Canada's exports of motion picture, audio and video, as well as other entertainment services, including theatre, sports, gambling and other recreation activities topped $2.9 billion, compared to imports of similar services of $2.7 billion. Export growth (13.3 percent) also exceeded import growth (10.1 percent) over the reference period, allowing Canada to move from a deficit in these services in 1986 to a modest surplus in 1997. Rapid export growth of these services partly reflected the increasing numbers of audio-visual producers using Canada as a base for filming and producing.

Table 14. Cross-Border Trade by Industry: Motion Picture, Audio-Video, and Other Entertainment Services (C$ millions)

Exports by subsector	1986	1997	Annual average growth (%)	1986	1997	Annual average growth (%)
	Exports			Imports		
Total	736	2,918	13.3	945	2,726	10.1
▪ Movies, audio & video	197	1,548	20.6	267	1,051	13.3
▪ Movies exhibition	2	5	8.7	1	4	13.4
▪ Theatre, sports & other rec.	537	1,350	8.7	677	1,657	8.5
▪ Lottery, bingo, casinos etc.	0	15	n/a	0	14	n/a

Source: Appendix Table A1.

While Canada performed well in cross-border trade in these industries, Mode 3 performance was even more striking. Affiliate sales of services related to motion pictures and sound recording by Canadian-owned firms in the United States totalled $5.6 billion in 1997, representing 39 percent of total affiliate sales by foreign-owned firms in the U.S. market. Canada and the United Kingdom were the largest foreign-owned suppliers of motion pictures to the U.S. market.

By contrast, foreign affiliate sales of entertainment, recreation and amusement services in Canada totalled $3.1 billion in 1997, accounting for 12 percent of the Canadian market. Affiliate sales by foreign-owned firms in Canada grew at an annual growth of 12.5 percent over the reference period.

Education and health services

Education services reported in this study include four components: private education services, non-profit education services, university education and "other" education services. With regard to health services, for imports, there is a breakdown between health practitioners and laboratories versus hospitals; exports, however, are not further broken down and, moreover, the data are muddied by the inclusion of some social services.

Suppliers of education and health services provide services to foreign customers mainly through Mode 2 (consumption abroad—e.g. studying abroad or travelling to a foreign country for a medical procedure not available at home) and Mode 3 (establishing affiliates in foreign markets).

Two-way trade in these areas is relatively modest, although growth was reasonably robust over the reference period.

Table 15. Cross-Border Trade by Industry: Education and Health (C$ millions)

	1986	1997	Annual average growth (%)	1986	1997	Annual average growth (%)
	Exports			Imports		
Total	292	780	9.3	447	1,055	8.1
Total education services	183	592	11.3	263	681	9.0
Private	24	100	13.9	31	129	13.8
Non-profit	0	107	n/a	0	90	n/a
University	83	240	10.1	131	274	6.9
Other	76	145	6	101	188	5.8
Health services	109	188	5.1	184	374	6.7
Health practitioners & labs	n/a	n/a	n/a	20	44	7.4
Hospitals	n/a	n/a	n/a	164	330	6.6

Source: Appendix Tables A1 and A2. Note: Exports of health services also include some social services.

In education services, study abroad predominates over other modes of service supply. This probably reflects the fact that the unique features of each country's education system—its culture,

reputation and academic environments—cannot be easily replicated in another country.

In 1997, Canadian exports of education services totalled $592 million, having grown at an average annual rate of 11.3 percent from $183 million in 1986. Over the same period, spending by Canadians studying abroad, mostly in the United States, also increased substantially from $263 million to $681 million, an average annual increase of 8.1 percent.

Cross-border trade in health services was even smaller and also grew less rapidly over the reference period. In 1997, Canada exported $188 million of health-care services, up from $109 million in 1986. In the same year, Canadians purchased $374 million of similar services from abroad, resulting in a trade deficit of $124 million.

The pattern of Mode 3 trade is reversed for these subsectors, with education trailing health care by a considerable margin.

Table 16. Mode 3 Exports to the United States by Industry: Education and Health Services (C$ millions)

	1990	1996	Annual Average growth (%) 1990-1996
Education & health total	(D)	1,373	n/a
Education services	(D)	3	n/a
Health services	578.7	1,370	15.4

Source: Appendix Table A2.

With regard to Mode 3 exports, data suppression for confidentiality reasons limits the period of observation to 1990-1996. While affiliate sales of education services by Canadian-owned education institutions in the United States were insignificant, Canadian health-care service providers had a respectable $1.4 billion of sales through affiliates in the United States in 1996, substantially greater than cross-border trade in this industry segment. Moreover, there is an indication of rapid expansion of Canadian commercial presence in this area, as sales grew an average annual rate of over 15 percent. Foreign affiliate sales are expected to continue to expand as population

aging in Canada and other industrialized countries boosts demand for health-care services. Pressure on domestic-supply capacity may make commercial presence of foreign-owned health-care firms increasingly attractive.

In Mode 3 imports, affiliate sales of education and health services by foreign-owned institutions in Canada were small, totalling only $99 million and $154 million in 1997 respectively (as noted above, the latter figure includes some social services). Growth was also relatively modest over this period.

Table 17. Mode 3 Imports by Industry: Education and Health Services (C$ millions)

	1988		1997		
	Revenue	Industry share (%)	Revenue	Industry share (%)	Annual average growth (%)
Education & health	125	n/a	253	n/a	8.1
Educational	54	9.9	99	6.4	7.0
Health and social	71	1.5	154	1.3	9.0

Source: Appendix Table A3.

Transportation services

We now turn to the sectors that are less intensive in the types of jobs that require advanced education, in particular, the transportation and travel-related sectors.[12]

[12] It is important to note that *all* services sectors are knowledge- and skill-intensive; few members of the general public (including most of the accountants, bankers, computer programmers, educators and health professionals working in the "knowledge-intensive" sectors discussed above) possess the skills to be a good short-order cook, to manage a hotel, drive a tractor trailer or fly a commercial jet liner. That being said, to enter many jobs in the foregoing industries appears to require a higher base of formal, theoretical knowledge than is required to enter the industries that we are about to consider. Moreover, rightly or wrongly, society places a differential value in the form of higher rewards to the services provided in the so-called "knowledge-intensive" sectors. Bearing in mind these reservations about the distinction, the convention of labelling certain industries as "knowledge-intensive" and others as "less knowledge-intensive" is maintained.

With regard to transportation services, the relative importance of cross-border trade versus affiliate sales varies depending on the type of transportation service provided. Generally speaking, cross-border trade predominates in water- and air-transport services, while affiliate sales play a more important role in land-transport services and services that are incidental to transport.

As shown in the panel below, in 1997, two-way trade in transportation services, including air, water and land modes (but excluding transportation margins[13]) totalled $17 billion in 1997. Between 1986 and 1997, two-way trade in transportation services grew at an annual average rate of 9.7 percent, with export growth modestly outpacing import growth.

Table 18. Cross-Border Trade by Industry: Transportation* (C$ millions)

	1986	1997	Annual average growth (%)	1986	1997	Annual average growth (%)
		Exports			Imports	
Total	3,483	10,092	10.2	2,684	7,087	9.2
Air	1,132	2,460	7.3	1,302	3,337	8.9
Rail	228	307	2.7	229	284	2.0
Water	613	1,602	9.1	302	518	5.0
Truck	557	2,737	15.6	208	1,757	21.4
Pipeline	760	2,612	11.9	329	494	3.8
Other	193	374	6.2	303	653	7.2

Source: Appendix Table A1. * Total here excludes transportation margins; in the Appendix tables, transportation margins are included in the total. "Other" includes bus, taxi and other interurban and urban-transit services.

[13] Transportation margins represent the portion of the export value of merchandise exports that reflects domestic transportation between the factory gate and the border. In the input-output accounts, transportation margins are broken out of the value of merchandise exports and are shown as exports of transportation services; however, there is no similar component in imports of transportation services. Accordingly, for purposes of analyzing the various transportation subsectors, we exclude transportation margins.

Air transport accounts for the largest share (a little over 40 percent in 1997) of two-way trade in transportation services. Canada ran a deficit in this sector, as imports of $3.3 billion exceeded exports of $2.5 billion in 1997. Moreover, this deficit expanded over the reference period, as growth of air-services imports exceeded that of exports. Given the extreme difficulties experienced by this industry in Canada and abroad since the attack on the World Trade Center and the Pentagon on September 11, 2001, the past is not likely to furnish an especially reliable guide to its future as regards services trade.

The fastest-growing transport mode during the reference period was trucking. This is an industry segment in which Canada has a trade surplus, with exports of $2.7 billion in 1997 substantially exceeding imports of $1.8 billion. However, import growth of 21.6 percent outpaced the robust growth of exports of 15.6 percent. The rapid growth of two-way trade in truck-transport services mirrored growing bilateral merchandise trade between Canada and the United States, which more than doubled since the Canada-U.S. Free Trade Agreement came into force. Truck-transport demand was also boosted by corporate restructuring in the 1980s and 1990s, which emphasized outsourcing and clustering of suppliers around large manufacturers to take advantage of "just-in-time" inventory systems.

Mode 3 trade in transportation services appears to be considerable. Canadian services suppliers exported transportation services through their affiliates established abroad worth $3.1 billion in 1998. This was in good measure due to Canada's strong presence in the U.S. rail-transport sector, where affiliates of Canadian firms rang up $2.6 billion in sales in 1998, accounting for 93.9 percent of total foreign affiliates sales in the United States in this sector.

Meanwhile, in terms of Mode 3 imports, Canadians purchased $7.4 billion of transportation and storage services from affiliates of foreign-owned firms established in Canada in 1997. Most of this growth may be inferred to have come from truck transport, although unfortunately these data are not broken out of the total.

Table 19. Mode 3 Exports to the United States by Industry: Transportation and Warehousing (C$ millions)

	1993	1998	Growth 1993-1998
Total	1,704	3,092	12.7
Air	n/a	0	N/A
Rail	n/a	2,633	N/A
Water	n/a	113	N/A
Truck	n/a	219	N/A
Support activities for transportation	n/a	128	N/A

Source: Appendix Table A2.

Table 20. Mode 3 Imports by Industry: Transportation and warehousing (C$ millions)

	1988		1997		
	Revenue	Industry share (%)	Revenue	Industry share (%)	Annual average growth (%)
Transportation & storage	1,248	4.4	7,383	17.1	21.8
Air transport	195	2.4	627	4.6	13.9
Water transport	229	6.6	679	13.0	12.8
Urban transit & others	n/a	n/a	335	9.4	n/a
Oil & gas pipeline	234	4.9	184	1.6	-2.6
Other	590	n/a	5,558	n/a	28.3

Source: Appendix Table A3.

Insofar as sectoral data are available, perhaps the most interesting transport-industry segment is air-transport services. Liberalization of the Canadian airline industry through a series of bilateral agreements significantly boosted the sales of air-transport services by foreign-owned firms in Canada over the reference period. Since 1988, sales of air-transport services by affiliates of foreign-owned firms in Canada tripled to reach $627 million in 1997 from $195 million in 1988. Correspondingly, the share of sales by foreign-owned firms in the Canadian air-transport industry rose to 4.6 percent in 1997 from 2.4 percent in 1988.[14] However, as noted, recent events

[14] For a detailed analysis on this issue, see Sangita Dubey and François Gendron "The U.S.-Canada Open Skies Agreement: Three Years Later," Statistics Canada, Catalogue No. 87-003-XIB, 1999.

call into question the information value of these past developments.

Travel-related services

For analytical purposes, we group several categories of services of what might be considered travel-related services. The major categories are accommodation, and food and beverage services, both of which are major line items in the input-output accounts. As well, we break out of the "household and personal services" category, the major component of auto and machinery leasing, relegating the remaining small items to the miscellaneous category. We also pull out of the input-output "other services" category two distinctly travel-related subcategories: travel services, and parking and other services.

These services are traded through Mode 2, when customers travel abroad to obtain these services. These industries feature many jobs that are low-paid and low-skilled. However, one distinguishing feature of these services jobs is that they do not face direct-wage competition from low-wage countries as in goods trade, because services industries are not as footloose as many of their low-skilled counterparts in the manufacturing sector.

Table 21. Cross-Border Trade by Industry: Travel-related Services (C$ millions)

	1986	1997	Annual average growth (%)	1986	1997	Annual average growth (%)
	Exports			Imports		
Total	3,404	6,780	6.5	3,840	9,560	8.6
Accommodation	1,659	2,622	4.2	2,255	5,196	7.9
Food & beverage	1,189	2,914	8.5	1,067	2,904	9.5
Auto & machine leasing	226	336	3.7	199	359	5.5
Travel services	124	337	9.5	28	71	8.8
Parking & other services	206	571	9.7	291	1,030	12.2

Source: Appendix Table A1.

Canada's balance on trade in travel-related services deteriorated over the reference period, falling from near balance in 1986 to a sizeable deficit in 1997. This reflects, for the most part, deterioration in the balance on accommodation services. In 1997, Canada's exports of accommodation services totalled $2.6 billion, only half as much as the $5.2 billion that Canadians imported. By contrast, in 1986, imports and exports in this category were in near balance. This is a curious development, since there was no similar deterioration in the food and beverage sector.

One may speculate that the divergence between sales of accommodation services, and food and beverage services, reflects a terms of trade shift against Canada. This could be explained by the deterioration in Canada's exchange rate over the reference period: food, as a traded commodity, would have experienced compensating price increases; on the other hand, hotel accommodation, which is not traded, might not have experienced a similar offsetting price increase. In the context of price-inelastic demand for travel services, the observed divergence would make sense. This issue bears some study.

There is limited information available on Canada's Mode 3 exports to the United States. There is a small Canadian commercial presence in the hotel sector.

Table 22. Mode 3 Exports to the United States by Industry: Travel-related Services (C$ millions)

	1989	1998	Growth
Travel-related services total	(D)	(D)	n/a
Hotels & other lodging places	123	257	8.5
Food & beverage	(D)	(D)	n/a
Equipment rental & leasing	(D)	212	n/a
Travel arrangement & reservation services	n/a	21	n/a

Source: Appendix Table A2.

Mode 3 imports are significant in the travel-related services with an extensive foreign commercial presence in all the major industry segments and robust growth, especially in auto rentals.

Table 23. Mode 3 Imports by Industry: Travel-related services (C$ millions)

	1988		1997		
	Revenue	Industry share (%)	Revenue	Industry share (%)	Annual average growth (%)
Travel-related services	3,370	n/a	7,926	n/a	10.0
Accommodation	492	8.7	1,011	12.4	8.3
Food & beverage	1,589	9.8	3,472	14.5	9.1
Auto renting & leasing	758	29.5	2,672	40.5	15.0
Other consumer services	531	15.7	771	16.6	4.2

Source: Appendix Table A3.

Distribution

In the BOP accounts, wholesale and retail trade services are not considered to be tradable; transactions in these sectors are considered to take place between residents, not between residents and non-residents. The input-output accounts attribute quite a substantial value to cross-border trade in these sectors, however. This is due to a technical adjustment similar to that which generates a large value for transportation margins in that sector. In this case, Statistics Canada allocates to the wholesale and retail sale services, that portion of the value of merchandise trade that represents these sectors' share of the difference between factory-gate and at-the-border valuation. While these adjustments are important in terms of understanding the role that producer services play in supporting merchandise sector activity, they are not relevant to a discussion of the gains from, or impact of, trade liberalization.[15]

[15] For the record, with the adjustments, trade in wholesale services turns out to be one of Canada's largest services exports at $10 billion in 1997. This was significantly higher than imports of $2.4 billion recorded in the same year. As in the case of transportation margins, the difference in the basis of valuation of exports and imports does not make a direct comparison of these figures meaningful. The growth in trade in these sectors reflected the rapid growth of merchandise trade during the reference period. Canada's trade in retail services was much smaller. In 1997, Canada exported $680 million of retail services and imported $456 million from the world.

Mode 3 trade is more meaningful in the distribution sector. Canada's commercial presence in the U.S. wholesale and retail market appears to be very weak and indeed in decline.

Table 24. Mode 3 Exports to the United States by Industry: Distribution Services (C$ millions)

	1989	1997	Annual average growth (%)
Distribution	491	176	-12.1
Wholesale trade	199	151	-3.4
Retail trade	292	24	-26.8

Source: Appendix A2.

This may be partly due to a lack of major Canadian-owned manufacturers of consumer durable goods (wholesaling affiliates are often owned by manufacturers to serve as their representatives in foreign markets). In retail trade, the issue may be a lack of major Canadian-owned retail chains in the United States.

Mode 3 imports are another story altogether. Affiliate sales of wholesale services by foreign-owned firms in Canada were $58.9 billion in 1997; this was, by far, the largest foreign affiliate sales total among major industrial categories.

Table 25. Mode 3 Imports by Industry: Distribution Services (C$ millions)

	1988		1997		
	Revenue	Industry share (%)	Revenue	Industry share (%)	Annual average growth (%)
Distribution	43,864	n/a	81,556	n/a	7.1
Wholesale trade	26,590	20.3	58,875	32.8	9.2
Retail trade	17,274	13.0	22,681	13.1	3.1

Source: Appendix A3.

Despite the entry of several high-profile U.S. retail chain stores such as Wal-Mart and Price Costco into Canada in the 1990s, Mode 3 imports in Canada's retailing market remained relatively stable over the reference period at about 13 percent of the industry total. In the wholesale sector, however, Mode 3

imports expanded from 20 percent of the industry in 1988 to about 33 percent in 1997, despite the lack of fanfare.

A summary of industry trends

In summary, Canada's services trade expanded rapidly in both cross-border trade and commercial presence in recent years. Services that are complementary to merchandise trade, and that are associated with ongoing social, economic and technological changes, involving production and distribution of knowledge-intensive products, registered faster than average growth in both cross-border trade and affiliate sales. Transportation and wholesale services that support merchandise trade registered robust growth in recent years. The expansion of these services mirrored the surge of merchandise trade in North America since the implementation of the FTA and the NAFTA; other factors contributing to this trend include increased fragmentation of production across borders in conjunction with corporate restructuring that resulted in outsourcing of specialized production.

This review shows that, despite Canada's overall apparent deficit position in services trade, Canadian suppliers have been doing very well in what might be called the "professional" services sectors, such as business services. On the other hand, Canada's traditional weakness in the services sector is clearly seen to lie in what might be termed the "industrial" services—for example, transportation and distribution—although there are, of course, exceptions to this broad generalization (Canada does well in Mode 3 exports of rail services to the United States and conversely cross-border imports of broadcast services dominate Canada's export performance in this sector).

We now turn to a consideration of the implications of this analysis in terms of gains from trade in the Doha Round of multilateral trade negotiations, given what is known about trade barriers in the various sectors across trading partners. In approaching this issue, we pay particular attention to the issue of job quality and how that might be affected by trade liberalization.

Based on the above evidence, the prior expectation would be that trade liberalization would be consistent with promoting knowledge-intensive services sector's growth in Canada. This reflects, in particular, the rapid two-way growth of professional services; this indicates that firm-level specialization drives trade rather than broader economic forces of comparative advantage. Moreover, there is a strong record of provision of these services on a cross-border basis, which is also of interest in terms of stimulating employment growth domestically.

Implications of further liberalization of services trade

Trade intensity by sector

In considering the economic implications of services trade liberalization, it is useful to put the preceding discussion of industry trends into perspective by comparing the level of exports and imports in the various sectors, by the different modes, to the level of GDP in these sectors. This provides a sense of the significance of trade for the various sectors.

Table 26 reports the export share of GDP by industry.[16] As can be seen, services overall are far less traded than most goods. Services exports represented just 11.8 percent of services production in 1997 compared with a figure of 99.2 percent for merchandise exports.[17] This reflects the fact that a large number of Canada's private commercial services remain almost completely outside of the global trading system. For instance, cross-border exports of construction and retail trade, as well as personal and household services, represent only minuscule

[16] Table 26 reports domestic exports of services only. If re-exports of $17.9 billion are included, Canada's total services exports in 1997 were $342.1 billion.

[17] Note that the value of exports in a sector can exceed the value of the sector's GDP. This reflects the fact that GDP measures value-added in Canada, while the total value of exports includes intermediate inputs, including those imported from abroad.

shares of their sectoral GDP. The socially sensitive sectors of education and health also had minuscule trade exposure.

Moreover, some services are non-commercial in nature, for instance, governmental services, membership organizations and some social services, which are mainly carried out within national boundaries. Typically, these non-commercial services are neither tradable on a cross-border basis nor attractive commercially in terms of establishing affiliates abroad. In 1998, total output of these non-tradable services combined, plus owner occupied housing, represented 15 percent of Canada's GDP. This means that, while services production accounted for 65.3 percent of GDP in 1998, only 50 percent was potentially tradable.

As can be seen, some services industries are far more trade-dependent than others. For example, in professional services, exports represented 38.4 percent of the subsector's GDP. Other services that had a relatively high export share of sectoral GDP include transportation, travel-related services such as accommodation, amusement and recreation, as well as insurance, and services supplementary to merchandise trade such as transportation and wholesales services.

It is also of interest to examine the trade exposure of the various sectors in terms of the role of imports. This is provided in Table 27. Overall, the trade exposure has a similar structure of trade dependence in Table 26. Professional services, insurance, amusement and recreation, and transportation, as well as accommodation and food, have a high level of trade exposure to foreign imports, while retail trade, personal and household services, and health and education have less exposure to foreign competition.

There are some subsectors that depend more on foreign markets while facing less competitive pressure from imports. The trade-dependence ratio for wholesale trade was 24.5% in 1997, but the trade-exposure ratio was only 5.5%. This suggests that traders use more Canadian wholesale services than counterparts in foreign countries.

Table 26: Trade Dependence of Canadian Service Industries: Exports, 1997 (C$ millions)

	GDP	Sector share (%)	Domestic exports	Mode 3 exports to the U.S.	Domestic exports/ GDP (%)
Business services	41,576	5.5	9,737	n/a	23.4
Professional services	18,565	2.4	7,123	883	38.4
Advertising	2,078	0.3	252	29	12.1
Other business services	20,932	2.8	2,362	n/a	11.3
Finance ins. & real est.	69,913	9.2	6,710	16,822	9.6
Finance & real estate	58,590	7.7	3,653	4,784	6.2
Insurance	11,323	1.5	3,057	12,037	27.0
Communications	22,755	3.0	2,169	4,489(2)	9.5
Amusement & recreation	8,286	1.1	2,918	(D)	35.2
Education & health	92,985	12.2	780	(D)	0.8
Education	41,798	5.5	592	3	1.4
Health & social services	51,187	6.7	188	1,370(1)	0.4
Transport & storage*	34,661	4.6	10,633	5,862	30.7
Transportation	29,903	3.9	7,480	(D)	25.0
Travel-related services	n/a	n/a	n/a	n/a	n/a
Accommodation & food	19,494	2.6	5,536	(D)	28.4
Distribution	84,931	11.1	11,240	252	13.2
Wholesale trade	43,150	5.7	10,560	151	24.5
Retail trade	41,781	5.5	680	101	1.6
Miscellaneous	68,845	9.0	2,454	n/a	3.6
Total services**	443,446	58.2	52,177	48,543	11.8
Memo					
Total merchandise	264,269	34.7	262,277	n/a	99.2
Manufacturing	144,293	18.9	223,773	n/a	155.1
All industries	761,853	100.0	324,189	n/a	42.6

Sources: Statistics Canada's input-output table, CANSAM matrix 4765 and 4766. "U.S. International Services: Cross-Border Trade and Sales Through Affiliates," published by The U.S. Department of Commerce, the Bureau of Economic Analysis

Note: Statistics on the performance of U.S. affiliates of Canadian firms in non-service industries are available, but they are collected in different surveys. Therefore, they are reported in this table.

* Excluding transportation margins. **Excluding owner-occupied housing and transportation margins. *** Non-tradable services include governmental services and membership organizations. (1) Supplemented by 1996 figures. (2) Supplemented by 1998 figures.

Table 27: Import Share of Canadian Service Industries: 1997 (C$ millions)

	GDP	Sector share (%)	Imports	Mode 3 imports	Domestic imports/ GDP (%)
Business services	41,576	5.5	9,759	8,511	23.5
Professional services	18,565	2.4	6,240	(D)	33.6
Advertising	2,078	0.3	489	(D)	23.5
Other business services	20,932	2.8	3,030	(D)	14.5
Finance, ins. & real estate	69,913	9.2	8,525	46,576	12.2
Finance & real estate	58,590	7.7	4,154	n/a	7.1
Insurance	11,323	1.5	4,371	n/a	38.6
Communications	22,755	3.0	2,804	8,650(1)	12.3
Amusement & recreation	8,286	1.1	2,726	3,089	32.9
Education & health	92,985	12.2	1,055	253	1.1
Education	41,798	5.5	681	99	1.6
Health & social services	51,187	6.7	374	154	0.7
Transportation*	29,903	3.9	7,087	7,383	23.7
Travel-related services	n/a	n/a	9,560	7,155	n/a
Accommodation & food	19,494	2.6	8,100	4,483	41.6
Distribution	84,931	11.1	2,838	81,556	3.3
Wholesale trade	43,150	5.7	2,382	58,875	5.5
Retail trade	41,781	5.5	456	22,681	1.1
Miscellaneous	68,845	9.0	1,247	1,048	1.8
Total services**	443,446	58.2	45,601	126,666	10.3
Memo					
Total merchandise	264,269	34.7	280,869	137,304	106.3
Manufacturing	144,293	18.9	263,336	111,987	182.5
All industries	761,853	100.0	326,470	518,922	42.9

Sources: Statistics Canada's input-output table, 1997, and survey of industrial organizations and finance.

Note: (1) includes utilities; (2) includes fishing; (3) includes forestry only.

: * Excluding transportation margins.

**Excluding owner-occupied housing and transportation margins.

Trade in services is limited by various barriers and impediments. Even in industrialized countries that have relatively liberal merchandise trade regimes, barriers to trade in services and movements of natural persons can be particularly restrictive. These barriers have severely limited services trade. Indeed, estimates suggest that interprovincial trade in services is between 30 and 40 times more intense than that between provinces and states.[18]

In recent years, significant progress has been made in the measurement of the size of barriers to services trade.[19] The latest estimates show that, overall, Canada is relatively open in environmental services, value-added telecommunications, rental services, maritime transportation and computer services, while it is restrictive in postal services, basic telecommunications, audio-visual services, some professional services and education.[20] These estimates reflect Canada's existing domestic regulatory regimes and, to a certain extent, the competitiveness of each service sector in the global market

Finally, natural barriers such as language, culture and differing legal systems appear to be a more formidable challenge to service suppliers than to suppliers of merchandise. Engineers would find it extremely difficult to market their skills to a foreign customer, if they do not know their customer's language. A service supplier would hesitate to establish a permanent presence in a host country in which the language,

---

[18] John F. Helliwell, *How Much Do National Borders Matter?* (Washington, D.C.: Brookings Institution Press, 1998).

[19] For a detailed review of the literature on measuring the barriers to trade in services, see Zhiqi Chen and Lawrence Schembri, "Measuring the Barriers to Trade in Services: Literature and Methodologies," in this volume.

[20] Pacific Economic Cooperation Council (PECC) 1995, Survey of Impediments to Trade and Investment in the APEC Region. Singapore: PECC.

culture and legal systems depart drastically from those in the home country.

From the above analysis, it can be seen that plenty of scope remains for exports of services to increase over time, to the extent that regulatory and other trade barriers are relaxed. A recent study indicates that an assumed 33 percent reduction of services barriers could increase world services exports by US$118.6 billion, with US$35.5 billion for the United States and US$6.6 billion for Canada.[21]

The economic impact of the structural shift toward a knowledge-based services economy

From the preceding discussion, the scope for gains in trade seem best in two areas: consumer services and producer services (including both professional and industrial). Prospects are least in the social services and in certain services that, for the most part, can be treated as "non-traded." How is Canada positioned to benefit from liberalization in these areas?

Sectoral considerations

Table 28 documents the sizeable shift toward spending on services in Canadian household expenditures in recent years. While household expenditures on goods increased by a total of 6 percent in real terms between 1986 and 1996, spending on services rose by a total of 34 percent over the same period. As a result, the share of services in total Canadian household expenditures increased to 41.0 percent in 1996 from 35.6 percent in 1986.

[21] Drusilla K. Brown, Alan V. Deardorff and Robert M. Stern (2001) "CGE modeling and analysis of multilateral and regional negotiating options," Discussion Paper No. 468, The University of Michigan.

Table 28. Household Expenditures on Services and Goods, 1986 and 1996

	Services	Goods	Total
Levels			
Expenditures in 1986 ($ billions)	103.9	187.9	291.8
Expenditures in 1996 ($ billions)	138.8	199.4	338.2
Growth			
Percentage change 1986-1996 (%)	33.6	6.1	15.9
Shares			
Shares of household expenditure 1986 (%)	35.6	64.4	100.0
Shares of household expenditure 1996 (%)	41.0	59.0	100.0

Source: Statistics Canada, *Services Indicators*, 2nd Quarter 1998.

As household expenditures on services increased, the share of expenditures going to the various services sectors changed, as shown in Table 29. Not surprisingly, the services sectors that commanded a rising share of household spending such as communications, recreation and financial services, also enjoyed higher output and employment growth.

Table 29. Canadian Household Expenditures on Various Services, 1996

	Expenditures in 1996 (billion of dollars)	Percentage change over the period 1986-1996
Financial services	52.3	34.0
Food & beverages	18.6	7.0
Communications	12.0	72.0
Amusement & recreation	8.5	47.0
Personal & household	6.1	29.0
Traveller accommodation	3.9	27.0
Others	37.4	39.0

Source: Statistics Canada, *Services Indicators*, 2nd Quarter 1998.

These changes in expenditure patterns were the result of a number of factors, including not only the differential impact of growing per-capita incomes on different types of services, but also of demographic trends and product innovation in many services industries

Perhaps the most general factor underpinning the rise in the share of services in household expenditures is the operation of

what is known as Engel's Law. This articulates the well-known empirical regularity that, as a given household becomes better off, it spends a smaller proportion of its budget on necessities such as food and a larger proportion on luxuries such as recreational goods and services. This means that, as consumers grow more prosperous, we would expect their demand for many types of services to grow faster than their demand for goods.

The data in Table 29 provide evidence supporting this hypothesis. For example, between 1986 and 1996, Canadian household spending on amusement and recreation services increased by 47 percent. These non-essential services account for a low share of household expenditures at low per-capita incomes, but demand increases dramatically as consumers become more prosperous.[22]

Similarly, the rise in spending on communications services (a gain of 72 percent over the period) and on financial services (a gain of 34 percent) also undoubtedly reflected an Engel's Law effect, although technological advances, which expanded the range of communications services, and product innovation and regulatory changes, which expanded the range of financial services that is available on the market, as well as relative price declines in these sectors, also undoubtedly played important roles.

On the other hand, there was comparatively little change in the consumption of personal and household services.

Demographic changes clearly have a profound impact on consumer-spending patterns. The dominant demographic fact in Canada and many other industrialized countries over the past several decades and prospectively in the coming few decades has been the relative decline of the population in the younger age brackets and the rise of the age group of 40 and 40-plus in the total population. Four fundamental forces have been mainly responsible for this trend:

---

[22] Note: This simple analysis ignores the role of relative price changes, demographic composition of households, the changing mix of goods and services available on the market, and other factors that might affect the relative share of expenditures.

- First is the increase in life expectancy, which, for the average Canadian, increased to 79 in 1997 from 71 in the early 1960s.
- Second is the emergence of the baby-boom generation after World War II, and the ensuing "baby bust." This demographic phenomenon is mirrored in the drop in the fertility rate from 3.8 per woman in 1960 to less than 2 per woman since the 1970s. Given the predictability of the aging process and the evolving patterns of consumer behaviour with age, it is possible to anticipate the social and economic impact of population aging on the output and employment structure of the economy. For example, the life-cycle theory of savings asserts that the objective of a consumer's consumption-saving decision is to smooth consumption over time, so as to maximize his or her overall lifetime utility. At a young and family-building age, an investor spends most of his or her limited savings on a house. As an investor grows older and has acquired sufficient housing, the priority turns to addressing the uncertainty of remaining lifetime income. This generates a stronger need to invest for retirement. The rapid growth of financial asset markets in North America in recent years thus partly reflects this underlying demographic change, as the baby-boom generation moved into the retirement-savings age brackets. Meanwhile, the continued increase in the fraction of those 65 and older has led to rising demand for health and leisure services.
- Third, the advances in information technology have created many entirely new services industries such as the Internet and the various on-line services now available, cellular telephony, and a host of other new services. The growth of these services bears a striking resemblance to some of the dynamic manufacturing industries that emerged in the past half century. They are to be distinguished from other traditional industries by high investment in R&D and a high concentration of skilled labourers, contributing new dimensions to the growing services sector in the economy.

- Fourth, the rising demand for services has encouraged capital and labour to be allocated toward services, as was documented above.

The labour market implications of the structural shift toward a knowledge-based services economy

The evolution of the economy from a resource- and manufacturing-dominated economy toward a knowledge-based services economy has led to many changes in Canada's labour market.

One distinguishing feature of the structural shift toward services is the boost that it has given to the importance of education. Over the course of the 20th century, the average level of education of the Canadian working-age population increased sharply. Many more Canadians than ever before are enrolling in post-secondary institutions, resulting in a rising proportion of workers with some college or university education. Figure 1 shows the rise in share of employment in Canada accounted for by those with some post-secondary training.[23]

Coupled with evidence from unemployment rates (those with higher education have lower unemployment rates),[24] this indicates that those who acquired the necessary education and training were rewarded in the labour market, while those who lacked that preparation had a harder time finding or keeping a job. For instance, between 1989 and 1995, the number of

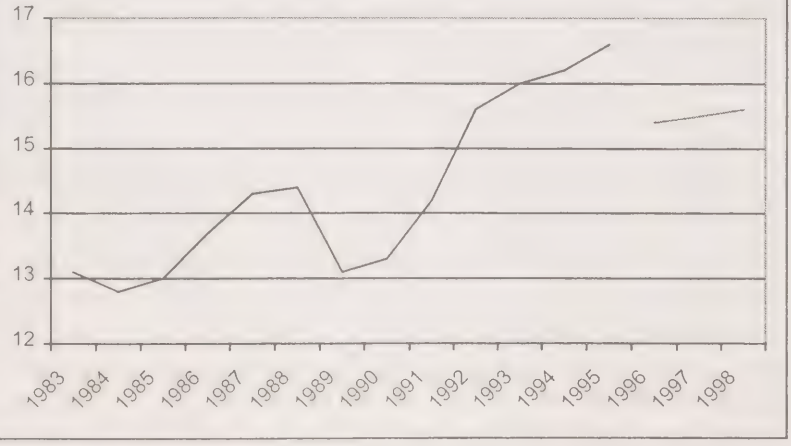
---

[23] The broken line in Figure 2 is due to the change in the educational classification. Starting in 1996, Statistics Canada's *Survey of Labour and Income Dynamic* included a new category for respondents who "don't know" what their educational attainment is. Since these had previously been allocated across the various categories, there is a decline for all the categories, including those with higher education under the new classification system.

[24] See Statistics Canada, *Labour Force Update*, Catalogue no. 71-005-XPB, Table 9, Number Unemployment Rate by Age Group, Sex, Education and Province, 1998.

employed persons without any post-secondary training declined by 0.5 percent. By contrast, the number of employees with some post-secondary training, up to and including a bachelor's degree, went up by 31.3 percent, and those with some graduate training or post-graduate degrees, had the largest gain, 33 percent. The rise in employment of workers with post-secondary training was substantially larger than their share of the working-age population.

Figure 1. The share of employeeswith post-secondary training in total Canadian employment (%)



Insofar as higher education indicates a higher level of skill, one common explanation for the disproportionate increase in the share of employment accounted for by workers with post-secondary training is "skill-biased technological change"—technological change that expands demand for high-skilled workers more rapidly than for low-skilled workers. Within a given industry, this effect would lead to a secular rise in the number of employees with post-secondary training relative to those without. In addition, sectors that use skills and knowledge most intensively expanded more rapidly than less-skill-intensive industries. This too contributed to the rapid increase of employment of knowledge workers in the Canadian economy.

Also contributing to the rising share of highly educated workers was the emergence in recent decades of new industries enabled by innovation in information technology. The extensive use of information and communications technologies in these new industries placed a high premium on educational attainment of workers, since the development of new products and processes in these sectors were strongly dependent on the skills, expertise and experience embodied in their employees.

Services played an important role in this context. Table 30 shows the share of employment by industry group accounted for by those with some post-secondary training. As can be seen, the services sector had the highest relative share of highly educated workers of any sector in Canada in 1998 and also registered the largest gain in this respect between 1983 and 1998.

Reflecting their rising share of economic output and relatively high knowledge-intensity, the services industries employed more than 80 percent of those who had some post-secondary training up to and including a bachelor's degree and nearly 90 percent of those who advanced to graduate studies. Between 1989 and 1995, Canadian services industries created 709,000 jobs; of these, only 144,000 went to those who lacked post-secondary training, compared to 381,000 for those with some undergraduate training, and 184,000 for those with some graduate training.

Table 30. Share of Employees with Post-secondary Training in Total Employment, by Major Sector (percent)

	1983	1995	1996	1998
Total economy	13.1	16.6	15.4	15.6
Agriculture	3.7	6.9	6.5	7.1
Mining	14.0	10.5	12.3	13.0
Manufacturing	7.5	9.8	9.5	8.6
Construction	4.1	5.5	4.9	5.2
Utility	16.1	15.7	18.1	17.2
Services	15.8	19.7	19.8	19.7

Sources: Statistics Canada, *Survey of Labour and Income Dynamics 1996-1998* and *Survey of Consumer Finance 1983-1995.*

Table 31 presents a sectoral breakdown of Canada's services sector.

Table 31. Share of Employment accounted for by those with Post-secondary Training in Services, 1983-1998 (percent)

	1983	1995	1996	1998
Total services	15.8	19.7	19.8	19.7
Transportation & storage	5.2	6.3	4.3	5.6
Communications	13.8	16.9	15.3	14.6
Wholesale trade	8.9	12.5	11.9	12.8
Retail trade	5.6	7.6	7.5	8.1
Finance & insurance	11.7	22.7	21.2	20.4
Deposit-accepting intermediary industries	8.5	19.8	15.6	17.8
Insurance	14.9	21.5	23.2	15.2
Other financial intermediary	15.6	34.0	46.2	39.5
Real estate	13.0	17.5	17.6	16.9
Business services	28.7	35.7	35.8	32.1
Computer services	29.6	50.0	41.7	36.6
Accounting services	44.7	41.0	48.1	38.8
Advertising services	9.8	19.5	37.2	30.4
Arch., eng. & other sci. & tech.	32.1	47.0	39.2	39.9
Legal services	44.2	43.8	39.7	41.2
Management consulting	N/A	54.2	50.0	48.6
Other business services	12.0	15.1	19.2	14.8
Government services	20.7	24.7	23.2	23.5
Educational services	53.6	57.1	57.6	57.5
Health & social services	19.1	23.1	22.6	23.1
Accommodation, food & beverage	4.2	5.6	5.6	5.4
Accommodation	5.5	6.8	N/A	9.5
Food & beverage	3.6	5.4	5.6	4.3
Other services	8.7	10.7	11.0	12.0
Amusement & recreation	10.5	12.5	14.3	15.3
Personal & household	2.7	3.4	N/A	N/A
Membership organization	27.8	29.8	28.6	29.5
Other services	6.1	10.1	10.0	9.9

Sources: Statistics Canada, *Survey of Labour and Income Dynamics 1996-1998;* and *Survey of Consumer Finance 1983-1995.*

Not surprisingly, a high proportion of employees in the management consulting, education services, and the computer and engineering services industries has post-secondary training. The rising demand for business information and the widespread use of information technology also explains the high share of employment accounted for by highly educated workers in financial and advertising services. On the other hand, there was comparatively low demand for highly educated workers in retail trade, personal and household services, and accommodation, as well as in the transportation and storage, and food and beverage services. The latter two were among the industries with the lowest demand for highly educated workers.

Relative to services, manufacturing has low demand for highly educated workers, although some individual sectors such as the electrical and electronic-products industry, and the chemical-products industries had high concentrations of highly skilled workers. The rubber products, primary textiles, and clothing industries were among the Canadian industries with the lowest demand for highly educated workers.

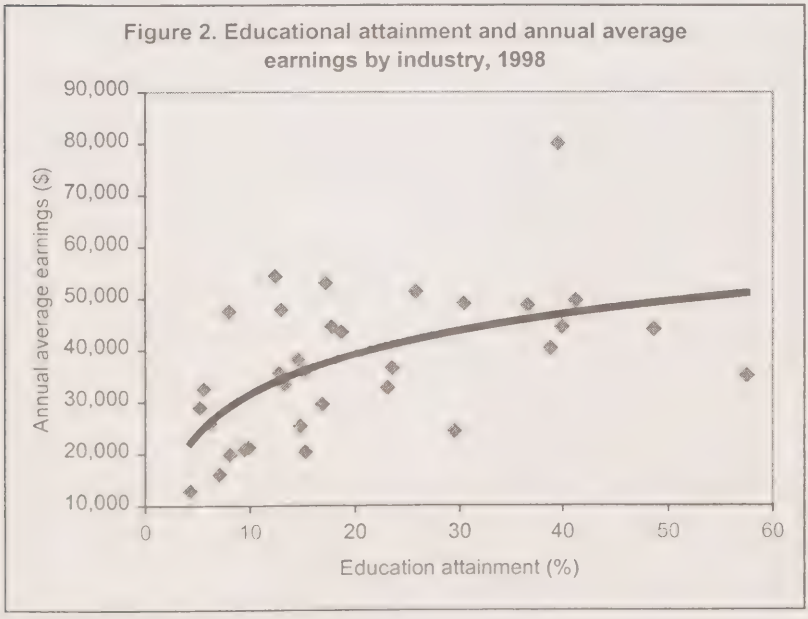
Similar trends are to be seen in terms of earnings. In the past decade, those who acquired the education and training that employers sought were rewarded with higher earnings, while those who lacked that preparation saw their earnings lag behind. Table 32 shows that, in 1998, the average earnings of a full-time worker with some post-secondary training, up to and including a bachelor's degree, were 70 percent higher than those of a high school graduate or a dropout. A full-time worker with some graduate training earned almost *two and half times* as much as the non-degree holder.

Figure 2 shows a clear positive correlation between workers' educational attainment and average annual earnings across industries, although there are some notable exceptions. For example, the share of employment accounted for by highly educated workers in "other financial intermediary services" was not among the highest, but average annual earnings topped $80,025 in 1998. By the same token, the share of highly educated workers was highest of all industries in education services, but average annual earnings were only $34,992.

Table 32. Average Annual Earnings of Canadian Workers 1989-1998 (in constant 1998 dollars)

	No post-secondary degree (1)	Bachelor's degree (2)	Graduate degree (3)	Total	Earnings premium (3/1)
1989	24,676	41,991	57,619	27,586	2.34
1990	24,743	39,882	54,626	27,352	2.21
1991	23,671	40,374	58,008	26,814	2.45
1992	23,793	39,954	54,470	27,022	2.29
1993	23,613	37,820	51,440	26,587	2.18
1994	24,329	39,231	54,249	27,476	2.23
1995	24,162	38,040	52,629	27,244	2.18
1996	23,998	39,345	52,696	27,107	2.20
1997	24,258	40,326	54,551	27,550	2.25
1998	24,848	42,361	60,635	28,557	2.44
Percentage change 1989-1998	0.70	0.88	5.23	3.52	

Source: Statistics Canada, *Survey of Labour and Income Dynamics 1996-1998.*



Despite these apparent anomalies, overall, a one-percentage increase in the share of highly educated workers was associated with a 0.29 percent increase in average annual earnings across industries. The concave shape illustrated in Figure 2 suggests diminishing relative returns to education. Holding all other factors constant, the relative rewards to education increased at a diminishing rate; in other words, an additional unit of education were worth less and less in financial terms the higher up the educational attainment ladder a worker climbed.

Table 33 shows that services contain some of the best-paid jobs in Canada. Highly educated workers earned extremely high average wages and salaries in the "other financial intermediary" ($96,605), advertising ($95,299), and deposit intermediary ($88,804) industries. The highest average wages outside services were in the mining and oil well industry, where highly qualified persons earned $81,630 a year.

It is surprising to see that, despite many success stories in Canada's high-tech industries, the average wages in the computer software and engineering services have not matched those in financial, advertising and legal services. The annual average earnings for highly educated workers in computer software and engineering services were $57,120 and $54,233, respectively, in 1998, compared to annual earnings of $96,605 for similar persons in the "other financial intermediary" industry.

Earnings in the overall services sector vary widely. Not every service industry is able to offer such well-paid jobs as do the financial and computer software services industries. The lowest-paid workers in some service industries earned less than the lowest-paid workers in industries outside of services. For example, a low-educated worker in personal and household services earned $11,852 a year, compared to $14,469 a year for a similar person in agriculture. Other low-earning service industries included amusement and recreation, food and beverage, accommodation, and retail trade.

Table 33. Average Annual Earnings of Canadian Workers with and without Post-secondary Education by Industry in 1998

	Secondary education or less	Post-secondary education	Overall
Agriculture	14,469	34,996	16,075
Mining, quarrying & oil wells	42,764	81,630	47,872
Manufacturing	35,493	63,378	37,793
Construction	28,890	32,313	29,000
Transportation and storage	31,899	44,974	32,559
Communications	35,271	56,239	38,266
Utility	48,920	73,641	53,101
Wholesale trade	32,112	56,080	35,650
Retail trade	18,926	31,940	19,890
Finance and insurance	35,724	84,421	46,005
Deposit-accepting intermediary	34,312	88,804	44,583
Insurance	31,453	54,174	35,980
Other financial intermediary	71,280	96,605	80,025
Real estate	25,371	48,475	29,668
Business services	30,358	59,750	40,254
Computer services	42,532	57,140	48,663
Accounting & bookkeeping	25,141	61,680	40,351
Advertising services	29,538	95,299	49,032
Arch., eng. & other sci. & tech.	36,358	54,223	44,438
Offices of lawyers & notaries	31,841	74,304	49,531
Government services	32,097	49,821	36,629
Educational services	24,635	41,991	34,992
Health & social services	26,552	52,909	32,742
Accommodation services	17,260	56,976	20,842
Food & beverage services	12,153	24,554	12,844
Other services	17,201	27,934	18,720
Amusement & recreation	17,733	29,992	20,436
Personal and household services	11,852	n/a	11,715
Membership organizations	20,961	31,632	24,366
Other services	20,636	27,247	21,374
Total	24,848	48,077	28,557

Sources: Statistics Canada, *Survey of Labour and Income Dynamics 1996-1998*; and *Survey of Consumer Finance 1983-1995*.

Contrary to the experience in the United States and other industrialized countries, where a sharp increase in the earnings premium was commanded by post-secondary training, even

given the structural shift toward services and the rise in demand for educated workers in Canada, there was no parallel increase in the earnings premium in Canada, at least since the late 1980s. The earnings premium between those with graduate training and those who did not advance beyond high school fluctuated over the course of the business cycle, but remained relatively stable in the range between 2.2 percent and 2.4 percent from the late 1980s through most of the 1990s (see Table 32). Scholars are debating the causes of a widening educational earning gap in the United States and other industrialized countries, and the reasons for a relatively stable earning premium to higher education in Canada. Murphy, Riddell and Romer believe that policies that facilitated substantial growth in post-secondary education during the past two decades in Canada may have had a major effect on wage inequality.[25] They conclude that, absent this expansion of educational attainment, Canada would have experienced an increase in income inequality between the more- and less-educated similar to that observed in the United States.

The evidence presented above shows that, overall, services are more knowledge-intensive than other sectors and, therefore, employ proportionately many more well-educated workers than other industries. However, the quality of jobs in services is especially diverse in terms of earnings, encompassing many of the highest-paid jobs in the economy and some of the lowest-paid. Thus, the employment shift toward services does not necessarily represent a shift from "good" to "bad" jobs, nor does it signal deterioration in overall job quality in Canada.

Conclusions

Canada has experienced significant shifts in the structure of Canada's services trade. Services that are associated with ongoing social, economic and technological changes, and are involved in the production and distribution of knowledge-

[25] Murphy, Kevin M., W. Craig Riddell and Paul M. Romer (1998). "Wages, skill and technology in the United States and Canada," NBER Working Paper 6638.

intensive products, registered rapid growth in both cross-border trade and affiliate sales. These services typically include business, financial and entertainment services, as well as services that are complementary to merchandise trade such as wholesale and transportation services. The expansion of both cross-border exports and sales of knowledge-intensive services by Canadian affiliates is an integral part to the structural adjustment toward a knowledge-based services economy.

Trade economists have always argued that, although trade is not expected to have a permanent impact on the level of employment over the long run—ultimately, it is the macroeconomic policy rather than trade policy that has been responsible for maintaining full employment—it would likely have a strong influence on the structure of output and employment. Increased trade in knowledge-intensive services would result in faster growth of output and employment in these sectors, contributing positively to the development of Canada's specialization in knowledge-based services industries.

Services are overall more knowledge-intensive than any other sectors; therefore, employing many more well-educated knowledge-workers than any other sectors. Service industries encompass many of the best jobs in Canada. The key to maintaining and improving Canada's standard of living is to encourage the development of Canada's specialization in knowledge-based services, generating many high-paid and high-quality jobs in Canada. Liberalizing services trade and investment is an important vehicle to achieve this end.

Nevertheless, despite the continuing expansion of international trade and investment in services, relative to the size of total domestic services, trade in services is still disproportionately small. A large proportion of services activity is still confined to a national boundary and home ownership. Even in some knowledge-intensive services sectors that registered fast trade growth in recent years; their trade performance could not match that of manufacturing. This suggests that plenty of room remains for a further expansion of trade and investment in Canada's knowledge-intensive business services.

Statistical Appendix

Table A1. Canada's Cross-Border Services Trade: Domestic Exports and Imports, 1986-1997 (C$ millions)

	Exports			Imports		
	1986	1997	Growth	1986	1997	Growth
Business services	2,243	9,737	14.3	3,912	9,759	8.7
Computer & related services	234	1,931	21.2	182	1,353	20.0
Accounting & legal services	60	358	17.6	84	523	18.1
Arch., eng., & sci. services	1,151	4,834	13.9	2,266	4,364	6.1
Advertising services	46	252	16.7	242	489	6.6
Miscellaneous business serv.	752	2,362	11.0	1,138	3,030	9.3
Finance, ins. & real estate	2,770	6,710	8.4	3,753	8,525	7.7
Banks, & other deposit-takers	1,227	2,130	5.1	595	1,820	10.7
Other finance industries	389	1,056	9.5	1,773	2,119	1.6
Insurance	1,061	3,057	10.1	1,303	4,371	11.6
Real estate	93	467	15.8	82	215	9.2
Real estate operator	24	30	2.0	52	20	-8.3
Real estate & insurance agent	69	437	18.3	30	195	18.5
Communications	949	2,169	7.8	889	2,804	11.0
Radio & TV broadcasting	20	71	12.2	46	370	20.9
Cable TV	16	22	2.9	11	229	31.8
Telecommunication carriers	716	1,430	6.5	732	1,642	7.6
Postal & courier service	197	646	11.4	100	563	17.0
Amusement & recreation	736	2,918	13.3	945	2,726	10.1
Motion picture, audio & video	197	1,548	20.6	267	1,051	13.3
Motion picture exhibition	2	5	8.7	1	4	13.4
Theatre, sports & others	537	1,350	8.7	677	1,657	8.5
Lotteries, bingos, casinos etc.	0	15	n/a	0	14	n/a
Education and health	292	780	9.3	447	1,055	8.1
Education services	183	592	11.3	263	681	9.0
Education services, private	24	100	13.9	31	129	13.8
Non-profit education	0	107	n/a	0	90	n/a
University education	83	240	10.1	131	274	6.9
Other educational services	76	145	6.0	101	188	5.8
Health & social services	109	188	5.1	184	374	6.7
Health practitioners & labs	n/a	n/a	n/a	20	44	7.4
Hospitals	n/a	n/a	n/a	164	330	6.6

Transportation	3,483	10,092	10.2	2,684	7,087	9.2
Air transport	1,132	2,460	7.3	1,302	3,337	8.9
Railway transport	228	307	2.7	229	284	2.0
Water transport	613	1,602	9.1	302	518	5.0
Truck transport	557	2,737	15.6	208	1,757	21.4
Pipeline	760	2,612	11.9	329	494	3.8
Natural gas	557	1,934	12.0	241	366	3.9
Crude oil & other	203	678	11.6	88	128	3.5
Other transport	193	374	6.2	314	697	7.5
Urban transit system	39	83	7.1	78	166	7.1
Interurban & rural transit	83	136	4.6	90	162	5.5
Taxicab & other transport	45	90	6.5	135	325	8.3
School & other bus	9	33	12.5	11	44	13.4
Other transport services	17	32	5.9	n/a	n/a	n/a
Travel-related services	3,404	6,780	6.5	3,840	9,560	8.6
Accommodation services	1,659	2,622	4.2	2,255	5,196	7.9
Food & beverage services	1,189	2,914	8.5	1,067	2,904	9.5
Auto & machinery leasing	226	336	3.7	199	359	5.5
Travel services	124	337	9.5	28	71	8.8
Parking & other services	206	571	9.7	291	1,030	12.2
Distribution	3,896	11,240	10.1	1,405	2,838	6.6
Wholesale trade	3,758	10,560	9.8	1,220	2,382	6.3
Wholesale margins	n/a	n/a	n/a	n/a	n/a	n/a
Retail trade	138	680	15.6	185	456	8.5
Miscellaneous services	6,725	11,486	5.0	609	1,247	6.7
Transportation margins	5,843	9,735	4.8	n/a	n/a	n/a
Storage	324	541	4.8	2	12	17.7
Grain elevator	319	521	4.6	0	1	n/a
Business membership assoc.	46	74	4.4	46	66	3.3
Other non-commercial	76	117	4.0	80	122	3.9
Sports & recreation clubs	10	23	7.9	11	22	6.5
Other non-profit organizations	66	94	3.3	69	100	3.4
Government services	421	905	7.2	471	964	6.7
Defence	8	36	14.7	11	44	13.4
Other municipal government	145	337	8.0	180	420	8.0
Other provincial government	124	245	6.4	146	260	5.4
Other federal government	144	287	6.5	134	240	5.4
Total services	24,498	61,912	8.8	18,484	45,601	8.6

Source: Statistics Canada, Input-Output Division.

Table A2. Sales of Services to U.S. Persons by Non-bank Majority-owned U.S. Affiliates of Canadian Companies 1989-1998 (C$ millions)

	1989		1998
Business services	394	Business services	1170
Computer & data processing	173	Computer & data processing	590
		Information & data processing	12
		Computer-systems design	578
Accounting, research, management, & related services	18	Accounting, research, management & related services	206
		Accounting & taxation	0
		Manage., sci. & tech.	7
		Legal	0
		Scientific R&D	199
Eng., architectural, & surveying services	197	Eng., architectural, & surveying services	265
		Arch. & eng. services	215
		Other professional serv.	50
Advertising	7	Advertising & related serv.	108
Finance, except banking	230	Finance (excl deposit-takers)	4486
		Non-deposit credit unions	1692
		Securities & investment	2794
Insurance	10,479	Insurance	15406
Real estate	4,930	Real estate	3528
Communications	44.3(1)	Communications	4489
Amusement & recreation	(D)	Amusement & recreation	(D)
Motion pictures	551.9(1)	Motion pictures	5631(4)
		Arts, entertainment & rec.	841
Education and health	(D)	Education and health	(D)
Education services	(D)	Education services	3
Health services	578.7(1)	Health services	1370(3)
Transport & warehouse	1703.8(2)	Transport & warehouse	7892
		Air transportation	0
		Rail transportation	2633
		Water transportation	113
		Truck transportation	219
		Support activities for trans.	128

Travel-related services	(D)	Travel-related services	(D)
Hotels & other lodging	123	Hotels & other lodging	257
Food & beverage	(D)	Food & beverage	(D)
Equipment rent & lease	(D)	Equipment rent & lease	212
		Travel arrangement & reservations	21
Distribution	491	Distribution	175.9
Wholesale trade	199	Wholesale trade	150.9(4)
Retail trade	292	Retail trade	25
Memo: services component in other sectors		*Memo: services component in other sectors*	
Agric., forestry & fishing	6	Agric., forestry & fishing	30
Mining	24	Mining	58
Manufacturing	(D)	Manufacturing	872
Public utilities	(D)	Public utilities	3252
Construction	(D)	Construction	47
Total services	**22,351**	**Total services**	**62,099**

Source: The U.S. Department of Commerce, the Bureau of Economic Analysis.
(1) Supplemented by 1990 figures
(2) Supplemented by 1993 figures
(3) Supplemented by 1996 figures
(4) Supplemented by 1997 figures
(D) Suppressed to avoid disclosure of data of individual companies.

Table A3. Sales by Canadian Affiliates of Foreign Firms in Canada 1988-1997 C$ millions)

	1988		1997		
	Revenue	Industrial share (%)	Revenue	Industrial share (%)	Annual Growth (%)
Business services	5,118	22.6	8,511	17.1	5.8
Computer & related	(D)	N/a	(D)	n/a	n/a
Architectural services	0	0.0	(D)	n/a	n/a
Advertising	(D)	N/a	(D)	n/a	n/a
Account. & management	684	11.6	2,113	12.4	13.4
Offices of eng.	321	7.7	1,204	14.5	15.8
Finance & insurance	29,067	23.8	43,990	25.7	4.7
Chartered banks	3,581	10.2	4,058	6.8	1.4
Trust companies	(D)	N/a	(D)	n/a	n/a
Other deposit-takers	(D)	N/a	0	0.0	n/a
Financial leasing	(D)	N/a	237	21.6	n/a
Other financing inst.	3,455	54.2	7,853	63.2	9.6
Other mortgage inst.	(D)	N/a	84	3.0	n/a
Life insurers	7,620	28.8	9,875	27.7	2.9
Property & casualty	9,064	62.0	14,965	59.3	5.7
Insurance agents	348	11.4	637	8.1	6.9
Deposit & health insurers	0	N/a	(D)	n/a	n/a
Investment dealers	(D)	N/a	(D)	n/a	n/a
Brokerage & others	596	13.0	1,054	16.2	6.5
Real estate	1,681	8.0	2,586	11.9	4.9
Communication & utilities	2,525	5.2	8,650	10.4	14.7
Entert., rec. & amusement	1,074	8.8	3,089	11.9	12.5
Educational services	54	9.9	99	6.4	7.0
Health & social services	71	1.4	154	1.3	9.0
Transportation & storage	1,248	4.4	7,383	17.1	21.8
Air transport	195	2.4	627	4.6	13.9
Railway transport	(D)	n/a	(D)	n/a	n/a
Water transport	229	6.6	679	13.0	12.8
Urban transit	(D)	n/a	335	9.4	n/a
Storage & warehousing	(D)	N/a	(D)	n/a	n/a
Pipeline	234	4.9	184	1.6	-2.6

Travel-related services	2,839	11.6	7,155	18.5	10.8
Accommodation food/bev.	2,081	9.5	4,483	13.9	8.9
Accommodation	492	8.7	1,011	12.4	8.3
Food & beverage	1,589	9.8	3,472	14.5	9.1
Motor renting & leasing	758	29.5	2,672	40.5	15.0
Distribution	43,864	16.6	81,556	23.1	7.1
Wholesale trade	26,590	20.3	58,875	32.8	9.2
Retail trade	17,274	13.0	22,681	13.1	3.1
Other services	604	12.5	1,048	17.1	6.3
Other consumer services	531	15.7	771	16.6	4.2
Building operations	73	5.2	277	10.5	15.9
Total services	88,144	17.5	126,666	17.7	4.1
Memo: affiliate sales in other sectors					
Agriculture & fishing	184	2.0	1529	6.2	26.5
Logging & forestry	129	3.4	170	1.9	3.1
Mining	11,650	50.6	23,619	49.8	8.2
Manufacturing	66,602	39.8	111,987	42.7	5.9
Construction	3,589	4.9	6,434	8.0	6.7
Total affiliate sales all industries	295,620	25.7	518,922	31.0	6.5

Source: Statistics Canada

Bibliography

Bergstrand, Jeffrey H. "The Heckscher-Ohlin-Samuelson Model, the Linder Hypothesis and the Determinants of Bilateral Intra-Industry Trade," *Economic Journal* 100, (December), pp. 1216-1229, 1990.

Brown, Drusilla K., Alan V. Deardorff, and Robert M. Stern., "CGE Modelling and Analysis of Multilateral and Regional Negotiating Options," Discussion Paper No. 468, The University of Michigan, 2001.

Chen Zhiqi, and Lawrence Schembri. "Measuring the Barriers to Trade in Services: Literature and Methodologies," in John M. Curtis and Dan Ciuriak (eds.), Trade Policy Research 2002 (Ottawa: Department of Foreign Affairs and International Trade, May 2002): 219-286.

Copeland Brian R. "Benefits and Costs of Trade and Investment Liberalization in Services: Implications from Trade Theory," in John M. Curtis and Dan Ciuriak (eds.), Trade Policy Research 2002 (Ottawa: Department of Foreign Affairs and International Trade, May 2002): 107-218.

Deardorff Alan V. "Determinants of Bilateral Trade: Does Gravity Work in a Neoclassical World?" NBER Working Paper Number 5377 (1995).

Dubey, Sangita and François Gendron. "The U.S.-Canada Open Skies Agreement: Three Years Later," Statistics Canada, Catalogue No. 87-003-XIB, 1999.

Helliwell, John F., *How Much Do National Borders Matter?* Brookings Institution Press, Washington, D.C. 1998.

Helpman, Elhanan and Paul Krugman. *Market Structure and Foreign Trade: Increasing Returns, Imperfect Competition, and the International Trade*, Cambridge, M.A.: MIT Press, 1985.

Krugman, Paul "Scale Economics, Product Differentiation, and the Pattern of Trade," *American Economic Review* 70:950-959, 1980.

Murphy, Kevin M., W. Craig Riddell and Paul M. Romer. "Wages, skill and technology in the United States and Canada", NBER Working Paper 6638, 1998.

OECD, *Services Statistics on Value Added and Employment*, 1996 and 2001 editions, Paris.

Pacific Economic Cooperation Council (PECC). *Survey of Impediments to Trade and Investment in the APEC Region*, Singapore, 1995.

Statistics Canada. *Canada's Balance of International Payments and International Investment Position: Concepts, sources, Methods and Products*, Catalogue No. 67-506-XIE, 2000.

Statistics Canada. *Canadian Economic Observer: Historical Statistical Supplement 1999/00.* Catalogue No. 11-210-XPB, 2001.

Statistics Canada, *Flow and Stock of Capital*, Catalogue No. 13-568.

Statistics Canada, *Historical Statistics*, Series D8-85.

Statistics Canada, *Labour Force Update*, Catalogue No. 71-005-XPB.

Statistics Canada. *The Input-Output Structure of the Canadian Economy 1961-1981*, Catalogue No. 15-510, 1987.

Statistics Canada, *Services Indicators*, 2nd Quarter 1998.

U.S. International Trade Commission. *Recent Trends in U.S. Services Trade*, Washington, D.C., 2000.

3 1761 11553226 9